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In the Supreme Court of the United States

OCTOBER TERM, 1963-4

INLAND EMPIRE BUILDERS, INC., J. C. BOESPFLUG CONSTRUCTION CO., and MCLAUGHLIN, INC., *Appellants,*

vs.

THE STATE OF WASHINGTON and WILLIAM S. SCHUMACHER, CLARK SQUIRE and A. E. HANKINS, as the TAX COMMISSION of the STATE OF WASHINGTON, *Appellees.*

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

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Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

INTRODUCTORY PARAGRAPH

Appellants appeal from the judgment of the Supreme Court of the State of Washington, which became final on September 26, 1963, affirming the judgment of the Superior Court of the State of Washington for Thurston County which held appellant contractors responsible and liable for the collection of sales tax on the price of military housing constructed under a contract between the appellant contractors and the United States pursuant to 42 U.S.C. Sec. 1594. This statement is submitted to show that the Supreme

Court of the United States has jurisdiction of this appeal and that a substantial question is presented.

OPINION BELOW

The opinion of the majority five judges and the opinion of the dissenting four judges of the Supreme Court of Washington is reported in 162 Wash. Dec. 609, — Wn.(2d) —, 384 P.(2d) 337. The Supreme Court opinion is attached hereto as Appendix A.

JURISDICTION

a. The appellant contractors commenced an action in the Superior Court of the State of Washington for Thurston County to enjoin the defendant State, acting through its Tax Commission, from collecting from appellants a money amount representing a consumer sales tax which appellants were allegedly obligated to collect on the contract price of their military housing construction contract, entered into by the Department of the Army and performed by appellants. The appellant contractors contended that the imposition of a liability for failure to collect the tax constituted an unconstitutional application of the state taxing statutes, Revised Code of Washington Title 82, under the United States Constitution.

b. The Superior Court decision denying appellant contractors relief and applying the taxing statute was entered July 3, 1961. The opinion of the Supreme Court of Washington affirming the trial court's decision, from which this appeal is taken, was entered August 1, 1963. Appellant's petition for re-hearing was denied on September 27, 1963, at which time the Supreme Court of

Washington's decision became final, and Notice of Appeal to this Court was served on December 18 and filed on December 20, 1963.

c. The jurisdiction of the Supreme Court of the United States to hear this appeal rests upon 28 U.S.C. Sec. 1257 (2).

4. The following cases, in which the above-entitled Court has accepted jurisdiction in a direct appeal under similar tax situations, are authority for accepting jurisdiction under a direct appeal in the present instance: *Esso Standard Oil v. Evans*, 345 U.S. 495, 97 L.ed. 1174; *Gwin, White & Prince v. Henneford*, 305 U.S. 434, 83 L.ed. 272; *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110, 98 L.ed. 546; *Railway Express Agency, Inc. v. Virginia*, 347 U.S. 359, 98 L.ed. 757, and *General Motors Corporation v. Washington*, Case No. 115, 1963 term of the United States Supreme Court.

STATUTES INVOLVED

a. The full text of the pertinent portions of Revised Code of Washington Sec. 82.04 and 82.08 are set forth in Appendix B. It is the application of the tax imposing portions of these statutes to the present transaction which is contended to be unconstitutional.

b. 69 Stat. 646; 42 U.S.C.A. Sec. 1594 *et seq.* This statute, known as the Capehart Act, constituted the statutory authority under which the United States through the Department of the Army entered into the construction contract involved in this case.

QUESTIONS PRESENTED

Is the application of the tax imposing provisions of the Washington Retail Sales Tax statute, which by its terms places the incidence of the tax on the purchaser, to the construction of Military Housing pursuant to a contract entered into between the appellant contractors and the United States, acting through the Department of the Army pursuant to authority of the Capehart Act (69 Stat. 646 *et seq.*, 42 U.S.C. Sec. 1594 *et seq.*), unconstitutional under the doctrine of sovereign immunity as imposing a tax on

a. the United States, or

b. an instrumentality of the United States entitled to equivalent immunity from state taxation?

STATEMENT OF THE CASE

Factual Background

The Capehart Act (69 Stat. 646 *et seq.*, 42 U.S.C. Sec. 1594 *et seq.*) created an authority whereby the various Military Departments of the United States could obtain the construction of military housing for service men by borrowing the funds from private lending institutions and repaying the loans over a 25-year period with funds obtained from annual appropriations. This program permitted the construction of a great deal more military housing through payment by the familiar installment plan than would have been possible if the construction could only be financed from funds currently available in each service's annual appropriations.

The housing as constructed became the property of and was fully under the control of the Military De-

partment involved, the construction was controlled and inspected in the same manner as other military construction jobs, the construction contract contained all of the standard provisions normally contained or required by law to be contained in a Federal procurement contract of such a nature, and the funds used to repay the loan came from military appropriations.

The savings and loan associations were deemed the principal source of the construction loans required. In order to comply with the loan security requirements imposed by the laws of various states on such associations, requiring principally an FHA secured mortgage, and in order to create the fiction of being a guarantor rather than a primary debtor as a device to avoid including the borrowed amounts in the national debt limitations and annual expenditure authorizations, the United States required that dummy corporations be created (Opinion of the Attorney General of the United States dated October 22, 1959; Tr. 0068, p. A-1).

These dummy corporations performed the function of signing a note to the lending institution secured by a mortgage on a nominal leasehold without right of possession, the repayment of which was unconditionally promised by the United States, and further of being a nominal signator to a construction contract also executed by the United States and the building contractor. The stock of the corporations was at all times during and after construction in the actual or constructive ownership of the United States, and particularly

when the construction loan advances allegedly subject to tax were made to the appellant contractors.

The United States had at a time previous to the creation of the dummy corporations already entered into a contract with the building contractor by written acceptance of the builders' bonded bid for performance of construction of the military housing involved.

In 1959 the appellant contractors entered into and performed such a contract with the United States Department of Army for the construction of approximately 850 units of military housing on the Fort Lewis Military Reservation at Tacoma, Washington (Tr. 0005, 0006). Appellants did not collect the sales tax on the price of the construction (Tr. 0010 F).

The Washington Retail Sales Tax Act imposes the liability and incidence of the Retail Sales Tax on the purchaser or buyer (RCW 82.08.050, App. B. p. 7), but makes the seller responsible for collection of the tax and separately liable if he fails to collect it (RCW Sec. 82.08.050, App. B. p. 7).

The Tax Commission of the State of Washington, appellees herein, applied the Washington Sales Tax statute to the appellants' construction of the Fort Lewis Military Housing and assessed a tax of $560,495.44 against these contractors.

How the Federal Question Was Presented

The appellant contractors brought suit against the Tax Commission to resist the application of the Washington Retail Sales Tax statute to them. In a pre-trial order in the Superior Court of Thurston County, Washington, which replaced the pleadings (Tr. 0002-

0016) the plaintiff contractors contended in paragraph 3 that the sale was immune from the state sales tax because it was a sale to the United States, in paragraph 4 that the Retail Sales Tax Act could not be applied to a sale to an instrumentality of the United States, and in paragraph 6 that the application of the tax act to the transaction involved was in violation of the United States Constitution (Tr. 0015).

The constitutionality under the United States Constitution of imposing the tax was one of the issues of law specified in the pre-trial order (Tr. 0016).

The trial court ruled adversely to plaintiff's contentions on the constitutional issue by concluding as a matter of law that the sale was to the corporations, not to the United States (Tr. 0037), and that the corporations were not exempt instrumentalities (Tr. 0036). The trial court further rejected the plaintiff's proposed conclusions of law to the contrary contained in paragraphs III, IV and V (Tr. 0055, 0056).

On appeal, virtually the entire argument related to (1) whether the United States was the buyer and therefore constitutionally exempt from the tax and (2) whether dummy corporations were instrumentalities of the United States and therefore constitutionally exempt. As stated in the five-Judge majority opinion (App. Ap.4):

> "The facts upon which these appeals are predicated are not in dispute. The legal issue involved is whether the transactions, pursuant to which the military housing was constructed, are shielded from state taxation by the sovereign immunity

> granted to the United States government by the federal and state constituions."

The issue is further considered by the four-Judge dissent at App. A, p. 17:

> "It is my disagreement with the majority in the disposition of the issue relating to whether the mortgagor-builder corporation is an instrumentality of the United States that brings me to a result contrary to that of the majority in this case."

THE QUESTIONS ARE SUBSTANTIAL

This case involves an asserted tax liability of $560,495.44 against appellant contractors, and when combined with the companion cases on appeal of *Ian Murray, et al. v. Washington* and *Hebb & Narodick v. Washington* (Supreme Court of Washington docket numbers 36226, 36228 and 36229, respectively) a total potential liability of over one million dollars is at issue.

The majority opinion of the Washington Supreme Court is, in the important constitutional aspects here involved, not only in conflict with the opinions of the Florida Supreme Court in *Green v. Eglin AFB Housing, Inc.*, Fla. (1958), 104 So.(2d) 463, and of the Michigan Supreme Court in *Knapp-Stiles v. Michigan Department of Revenue* (1963) 370 Michigan 629, 122 N.W.(2d) 642, but is in direct conflict with and does not even attempt to distinguish the most recent related decision of the United States Supreme Court on federal instrumentality as contained in its affirmance of *United States v. Livingston* (E.D., S.Ct.) 179 F.Supp. 9; aff'd 364 U.S. 281, 4 L.ed.(2d) 1719; pet. reh. denied 364

U.S. 855, 5 L.ed.(2d) 79, 81 S.Ct. 35. The genuineness of this conflict is established by the existence of a four-judge dissent to the Washington decision being appealed, which dissent is based on a view consistent with, *inter alia*, the foregoing cited cases (App. A, p. 17).

The decision of the Supreme Court of Washington tends to complicate and render uncertain the utilization of the Capehart method of financing and to subject projects utilizing such method to state taxation from which they are or ought to be otherwise constitutionally immune.

However, notwithstanding the substantial importance of each of the foregoing considerations, by far the most significant and far-reaching issue, and one involving a fundamental and heretofore universally accepted constitutional doctrine, is whether the concept of sovereign immunity of instrumentalities of the United States, as set forth in *McCulloch v. Maryland*, 4 Wheat. 316, 4 L.ed. 579, 17 U.S. 159; *Clallam County (Wash.) v. United States* (1923) 263 U.S. 341, 68 L.ed. 328, 44 S.Ct. 121, reiterated in *Kern-Limerick, Inc. v. Scurlock* (1954) 347 U.S. 110, 98 L.ed. 546, 74 S.Ct. 403, and recently confirmed in *United States v. Livingston* (E.D., S.Ct.) 179 F.Supp. 9; aff'd 364 U.S. 281, 4 L.ed. (2d) 1719; pet. reh. denied 364 U.S. 855, 5 L.ed.(2d) 79, 81 S.Ct. 35, will continue to exist.

Stated differently, and in the factual context of the present case, if a corporation formed for the United States which executes a note, mortgage and contract at the direction of and to serve the exclusive purpose

of the United States, which immediately after such function serves no other purpose, has no assets nor any possibility of acquiring assets or earning a profit and which is actually or constructively owned at all material times by the United States—if such a corporation is not an instrumentality of the United States, it is difficult to conceive any entity which could be such an instrumentality. If no entity can qualify as a federal instrumentality, the sovereign immunity concept of such an instrumentality as set forth in the foregoing cases will atrophy and disappear, whether specifically rejected or not.

The five-Judge majority of the Washington Supreme Court has as a practical matter rejected the doctrine of sovereign immunity of instrumentalities of the United States, and if that decision is permitted to stand by this Court, it will be hereafter universally cited to support such rejection. The substantial question of universal interest throughout the jurisdiction of the United States then becomes whether such a precedent should be accepted or reversed.

An immediate reaction may be that the foregoing contention of significance is exaggerated but we believe it can be demonstrated that such is not the case.

Practical limitations on the Jurisdictional Statement do not permit a detailed analysis of the virtually undisputed evidence contained in the admissions of fact in the pre-trial order, the twenty-five exhibits and the oral testimony at trial, to establish the uniquely singular purpose and function of the Capehart Corporation as an agent or instrumentality of the United States.

However, the substantiality of such evidence is established not only by the representations contained in the Statement of the Case herein, but by the characterizations and conclusions relating to these corporations contained in the following opinions:

(a) *Green v. Eglin AFB Housing, Inc.* (1958) 104 So.(2d) 463:

> [2] "Even if we regard the AFB corporation as private enterprises, their interest in the property is so negligible — lessees without right of use or possession — as to make it entirely unrealistic to hold that it destroys the status of these buildings as a part of the public works of the United States.
>
> "It is very doubtful if these corporations should be regarded as anything other than agencies or instrumentalities of the Federal Government. In *Clallam County, Wash. v. United States* [263] U.S. [341], [44 S.Ct. 121], 68 L.Ed. 328, the Supreme Court held that a corporation created for the purpose of operating a sawmill and railroad in the promotion of the war effort during the first World War and which was wholly owned by the United States was an agency of the United States and that its property was, therefore, immune from state taxation. In describing the corporation there involved the [*sic*] used language peculiarly applicable to each AFB corporation: 'The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends.' The creation of the AFB corporations was only for the convenience of the United States to enable it to finance military construction in a manner determined by the Congress to be most conducive to the national interest."

(b) *Knapp-Stiles, Inc. v. Michigan Department of Revenue* (1963) 370 Mich. 629, 122 N.W.(2d) 642:

> "In the instant case, as distinguished from *Offcutt* and *Dayton*, the lessee corporation got nothing, its leasehold interest was worth nothing to it or its stockholders, and the only ones receiving any benefits from the contractual arrangements were the department for whom the housing was built, plaintiff who presumably made some profit from building the same, and the mortgagees who apparently received interest on their loans. Nothing in that entire situation relieves the stark fact that the corporation was but a sham."

(c) Minority opinion in the present case at Appendix A, page 24:

> "In the instant case we should hold that, although the mortgagor-builder is the "buyer" to whom the retail sale of the housing project construction was made, it was nothing more than an instrumentality of the United States government; that it had no commercial purpose other than for the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the federal government applies."

The majority opinion below seeks to distinguish the above cases on the ground (App. A, p. 13):

> "In the *Green* and *Knapp-Stiles* cases, the result was determined by interpreting a state exemption statute much broader than our own, for which reason the cases are distinguishable."

This distinction is not valid. It is true that the Michigan and Florida Sales Tax Statutes have exemption provisions differing from the provision in the Wash-

ington statute, but it is also true that the Michigan and Florida tax statutes place the incidence of the tax on the *seller*. In both of these states the tax could be applied on the seller in a direct sale to the United States, but for the exemption provision of the statute. It is not now and has never been argued in this case that economic impact on the United States earned entitlement to constitutional immunity (*Alabama v. King & Boozer* (1941) 314 U.S. 1, 86 L.ed. 3, 62 S.Ct. 43, and *James v. Dravo Construction Company*, 302 U.S. 134, 82 L.ed. 155), and it is understood that under the present law, any seller may be taxed on sales to the United States.

By imposing the sales tax on the seller, the states of Florida and Michigan would have subjected the United States to the economic burden of the tax from which the United States was constitutionally immune in states such as Washington which places the incidence of the tax on the *purchaser*.

Without the express exemption extended to the United States by statutes in states such as Florida and Michigan, such states would probably see precious little Federal construction spending because of the unfavorable tax situation. Therefore, the exemption was enacted to furnish in such states protection to the United States equivalent to the constitutional immunity it enjoys elsewhere. It may be that the exemptions are not identical in scope with the constitutional immunity, but it will be seen that any deviations do not materially alter the basic identity of the central issue decided; that the sales are to the United States through an agency, or to a United States instrumentality.

The only similar tax case relating to Capehart construction and the issues here involved is *Silverblatt, Inc. v. New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, cert. den. 361 U.S. 912. The soundness of this opinion has been seriously questioned as follows in the minority opinion below (App. A, p. 22):

> "An analysis of *In re S. S. Silberblatt, Inc. v. Tax Comm. of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), cited by the majority, discloses that the opinion is based on the erroneous premise that the Delaware corporations were '... created for a commercial purpose for private profit, as distinguished from a governmental purpose.' As heretofore stated, consideration of the housing contract in its entirety cannot support such a conclusion. The analysis of the housing contract and the reasoning of the dissent in the *Silberblatt* case is correct."

Finally, one of the most significant conflicts in the Washington Supreme Court opinion and the one with possibly the broadest impact is the court's disregard of *United States v. Livingston* (E.D., S.Ct.) 179 F. Supp. 9; aff'd 364 U.S. 281, 4 L.ed.(2d) 1719; pet. reh. denied 364 U.S. 855, 5 L.ed. 79, 81 S.Ct. 35, and its reliance upon its own earlier decision in *DuPont v. State of Washington* (1954), 44 Wn.(2d) 339, 267 P.(2d) 91.

The facts of the two cases are virtually identical, each involving the management by DuPont for one dollar per year of an atomic production facility for the United States. If anything, the *Livingston* case is more similar to the present case because it involved application of a sales tax statute whereas *DuPont* involved application of a business and occupation tax

on DuPont's total expenditures at the Hanford, Washington Atomic Project.

Both cases were primarily decided on whether DuPont was such an agent or instrumentality of the United States that its activities were entitled to sovereign immunity. The Washington Supreme Court held that it was not, and cited its decision in support of the majority opinion in the present case. The three-judge Federal Court in the *Livingston* case held that DuPont was such an agent in operating the Savana River Atomic Project, and that its purchases were immune from taxation by the State of South Carolina. This decision was affirmed upon motion by this Court.

We submit that the decision of *DuPont v. Washington* is irreconcilable with and superseded by the decision in *United States v. Livingston*, and that the failure of the Washington Supreme Court to consider this conflict, although it was vigorously urged in both appellants' opening (Tr. 0068) and reply briefs (Tr. 0073), creates a conflict and uncertainty in the area of sovereign immunity that only the opinion of this Court, after full, plenary presentation, can resolve.

It is therefore urged that the present appeal involves several aspects of an important constitutional question of general concern, and should be granted a full hearing on briefs and oral argument.

Respectfully submitted,

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APPENDICES A AND B

Appendix A—Opinion of the Supreme Court of the State of Washington App. A, pages 3 to 24

Appendix B—Statutes Involved App. B, pages 1 to 13

APPENDIX A

OPINION OF THE SUPREME COURT OF THE STATE OF WASHINGTON

[Nos. 36226, 36227, 36228, 36229. En Banc. August 1, 1963]

IAN MURRAY *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *Appellant*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.*

Consolidated appeals from judgments of the Superior Court for Thurston County, Nos. 32176, 32186, 32195, 32196, Charles T. Wright, J., entered July 3, 1961. *Affirmed*.

Consolidated actions to recover taxes paid under protest. Plaintiffs appeal from judgments in favor of the defendant.

Bogle, Bogle & Gates, Edward G. Dobrin, and *Richard S. Sprague*, for appellants Murray *et al.*

Allen, DeGarmo & Leedy and *Seth W. Morrison*, for appellants Inland Empire Builders, Inc., *et al.*

Casey & Pruzan, by *Carl Pruzan*, for appellants Hebb & Narodick Construction Co., Inc., *et al.*

The Attorney General, John W. Riley, Chief Assistant, and *Timothy R. Malone, Assistant*, for respondents.

OTT, C. J.—This appeal is a consolidation of four actions brought by several contractors to recover a retail sales tax paid under protest, and to enjoin the State Tax Commission from assessing the sales tax in connection with the construction of Capehart Act housing at military installations in Washington.

From adverse judgments, the contractors appeal.

The facts upon which these appeals are predicated are not in dispute. The legal issue involved is whether the transactions, pursuant to which the military housing was constructed, are shielded from state taxation by the sovereign immunity granted to the United States government by the federal and state constitutions.

Each of the appellants was awarded contracts under the provisions of the Capehart Act (69 Stat. 651-654 as amended). Since the contract provisions are identical, we will refer only to the material portions of the documents in cause No. 36226. The procedure for the execution of a contract under the act, in so far as here material, may be stated as follows:

The Secretary of Defense, after determining a need for military housing, issues an invitation for bids. The contractor submitting the lowest acceptable bid receives a "Letter of Acceptability" from the Secretary. The letter requires the successful bidder to establish a private "mortgagor-builder" corporation under the laws of the state of Delaware, and to qualify it to do business in the state involved. The contractor furnishes the corporation with $1,000 for capital stock, purchases all of it, and elects its officers and directors. The United States government executes to the corporation a 55-

year lease of the real estate upon which the housing is to be constructed. The corporation is to obtain private financing by giving a mortgage on its leasehold, and obtain a commitment from the Federal Housing Administration to insure its mortgage loan. The mortgage loan in is the amount of the contractor's bid.

The "Letter of Acceptability" prescribes the "initial closing" procedure, which entails the execution of the following documents:

(1) The 55-year lease between the United States and the corporation for a consideration of $1,000, paid by the corporation to the United States government. The corporation agrees, during the period of construction, to maintain insurance and to save the United States government harmless from many laws, ordinances, and regulations applicable to the leased premises, with regard to construction, sanitation, licenses or permits to do business.

(2) The corporation executes a note, secured by a real and chattel mortgage on its real-estate leasehold, to the private lender.

(3) The corporation, contractor, and the United States execute a housing contract which provides that all construction is to be inspected and supervised by the United States; that progress payments are to be made by the corporation from the mortgage loan, upon request of the contractor and approval of the United States, and that, upon full payment, title to the housing units vests in the United States, subject to contractor liability for latent defects. The contract further provides that the contractor shall act as agent for the cor-

poration, guarantee its performance, and furnish a performance bond to the corporation and the mortgagee.

(4) An irrevocable escrow agreement is executed which provides that the resignations of the officers and directors of the corporation, and the stock certificates of the corporation, endorsed in blank, are to be placed in escrow, with instructions to the escrow holder to deliver these documents to the United States upon completion and acceptance of the project.

(5) The United States executes a written guarantee to pay the mortgage installment payments to the private mortgagee and or the Federal Housing Administration, the insurer.

The provisions of the Capehart Act were fully complied with by the contractors involved in these appeals.

Appellants' assignments of error ra two principal issues: First, the appellant contractors contend that, under Washington law, the consumer of the housing project is the party liable for payment of the sales tax, and that, as a result of the statutory method for the construction of Capehart housing, the United States is the consumer and, therefore, its constitutional immunity from state taxation applies. Secondly, appellants contend that the mortgagor-builder corporation is an agency of the United States and, as such, is immune from state tax.

[1] The function of interpreting state statutes to determine who is liable for payment of a sales tax is reserved to the state courts involved. *Alabama v. King & Boozer*, 314 U.S. 1, 86 L.Ed. 3, 62 S.Ct. 43, 140 A.L.R.

615 (1941); *Kern-Limerick, Inc., v. Scurlock*, 347 U.S. 110, 98 L.Ed. 546, 74 S.Ct. 403 (1954).

RCW 82.08.020 provides that " . . . there shall be collected a tax on each retail sale in this state . . . " A retail sale is defined in RCW 82.04.050 as including

" . . . the sale of or charge made for tangible personal property consumed and or for labor and services rendered in respect to the following: . . . (b) the constructing . . . of new or existing buildings or other structures under, upon, or above real property *of or for consumers*, . . . " (Italics ours.)

A consumer is defined in RCW 82.04.190(4) as "Any person who is an *owner, lessee or has the right of possession* to or an easement in real or personal property . . . " (Italics ours.)

RCW 82.08.050 provides in part:

"The tax hereby imposed shall be paid by the *buyer* to the seller, and each *seller* shall collect from the *buyer* the full amount of the tax payable in respect to each taxable sale . . .

"In case any seller fails to collect the tax herein imposed . . . he shall . . . be personally liable to the state for the amount of the tax." (Italics ours.)

Appellants concede that a retail sale, as defined in RCW 82.04.050, did occur, but contend that the consumer defined in RCW 82.04.190, and the buyer denominated in RCW 82.08.050 are synonymous, and that the United States government is the consumer and taxable party because it becomes the owner of the housing units upon their completion and acceptance.

[2] With this contention, we do not agree. One of the purposes of RCW 82.04.050 is to define the event that gives rise to a taxable transaction, which is the rendition of labor and services in the construction of new buildings upon real property of or for consumers. RCW 82.04.190 establishes the means by which the consumer is identified. These sections do not designate the party liable for payment of the tax in any given transaction. RCW 82.08.050 provides that the retail sales tax shall be borne by the buyer, who is primarily liable for payment of the tax. *Kaeser v. Everett*, 47 Wn.(2d) 666, 289 P.(2d) 343 (1955).

We must therefore determine who is the buyer under the facts of the instant case. In this regard, appellants contend that the United States is the buyer because it bears the economic burden of paying for the military housing, by virtue of its guarantee of the mortgage obligation.

In *Alabama v. King & Boozer, supra*, the state of Alabama, pursuant to a statute which imposed the sales tax upon the purchaser, levied a sales tax upon the sale of lumber to a contractor who was constructing installations for the Army. It was there contended that the sales tax could not be collected from the contractor for the reason that the United States was the purchaser, within the meaning of the Alabama statute. In answering this contention, the Supreme Court of the United States held:

" . . . The taxing statute, as the Alabama courts have held, makes the 'purchaser' liable for the tax to the seller, who is required 'to add to the sales price' the

amount of the tax and collect it when the sales price is collected, whether the sale is for cash or on credit. Who, in any particular transaction like the present, is a 'purchaser' within the meaning of the statute, is a question of state law on which only the Supreme Court of Alabama can speak with final authority. ***But it seems plain, as the Government concedes and as we assume for present purposes, that under the provisions of the statute the purchaser of tangible goods who is subjected to the tax measured by the sales price, is the person who orders and pays for them when the sale is for cash or who is legally obligated to pay for them if the sale is on credit*** . . ." (Italics ours.)

The court concluded:

"We cannot say that the contractors were not, or that the Government was, bound to pay the purchase price, or that the contractors were not the purchasers on whom the statute laye the tax. The added circumstance that they were bound by their contract to furnish the purchased material to the Government and entitled to be reimbursed by it for the cost, including the tax, no more results in an infringement of the Government immunity than did the tax laid upon the contractor's gross receipts from the Government in *James v. Dravo Contracting Co., supra* [302 U.S. 134]."

[3, 4] Applying this rule, the buyer is the person who is *legally obligated* to pay the seller in any transaction. The housing contract executed by the parties provided that "The mortgagor-builder [corporation] shall pay the eligible-builder [contractor] for the performance of this Housing Contract, and all other obligations of

the eligible builder herein, . . . " By the express terms of the contract, the corporation, and not the United States, was obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. Under the provisions of the Capehart Act and the facts in the instant case, the United States government was not obligated to pay the seller. The fact that the ultimate economic burden of the tax may fall upon the United States does not vitiate a state tax on the transactions. *Alabama v. King & Boozer, supra; Kern-Limerick, Inc., v. Scurlock, supra; United States v. Detroit*, 355 U.S. 466, 2 L.Ed.(2d) 424, 78 S.Ct. 474 (1958); *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn.(2d) 339, 267 P.(2d) 667 (1954).

Our conclusion in this regard is also supported by the following cases:

United States v. Harrison & Grimshaw Constr. Co., 305 F.(2d) 363 (1962), involved the question of whether the provisions of the Miller Act applied to the performance bond given by the eligible builder under a Capehart Act contract. The court held (p. 368):

" . . The projects are of a private nature until completition and assumption of control by the government. *The mortgagor-builder has a contract with a construction company to build the project. The constructor looks to the mortgagor-builder for payment for his work and owes to the mortgagor-builder the obligation to perform. . . .* " (Italics ours.)

In *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), it was said:

"Likewise, we must reject appellant's contention that the subject mortgages, as direct obligations to the United States, are immune from State or local taxation, as provided in section 3701 of the Revised Statutes of the United States (U. S. Code, tit. 31, § 742) which exempts 'Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States' since they are not 'of the same type as those specifically enumerated' in the statute (*Smith v. Davis*, 323 U.S. 111, 117). Under the arrangement authorized by the Enabling Act, it is clear that the device employed was designed to relieve the Government of its financially burdensome obligation to provide housing for its military personnel and at the same time avoid increasing the national debt. It did not pledge its credit in the usual sense, but merely guaranteed each 'periodic payment' based on a monthly average of $90 per family unit."

Congress, in its discretion, by enacting the Capehart law, chose to leave the hazards of construction, the purchasing of proper materials, and the furnishing of proper labor performance to private contractors and private lenders. It chose to guarantee only the payment to the private lender, after units acceptable to the government were erected upon the leased premises. We conclude, therefore, that the mortgagor-builder corporation was the party legally obligated to pay the contractor, and that it was the buyer denominated in RCW 82.08.050.

Is the mortgagor-builder corporation an agency of the United States?

Appellants contend that title to the units, when built in accordance with the contracts, vested in the United States; that the United States controlled and dictated the terms of the construction contracts, and that it guaranteed the mortgage obligation and ultimately gained ownership of all of the corporation's capital stock; hence, the corporation is a government agency.

In support of this contention, appellants rely on *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923); *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958); and *Knapp-Stiles, Inc., v. Michigan Department of Revenue*, CCH 2 Mich. Tax Cases ¶ 200-202 (1962).

The *Clallam County* case held that a corporation, organized pursuant to a World War I emergency act which authorized the Director of Aircraft Production to establish one or more state corporations to produce war materials, was an agency of the United States and, as such, its activities were exempt from state taxation. The case is not apropos. The Director of Aircraft Production was, by law, an agent of the government. In the instant case, the successful bidders were not authorized agents of the government. Furthermore, the facts in the cited case did not disclose any evidence of an intent to distinguish the corporate activities from those of the United States. In this regard, the court stated (p. 345): " . . . This is not like the case of a corporation having its own purposes as well as those of the United States . . . "

In the *Green* case, the court stated (p. 467):

" . . . The question here is the extent of an *exemp-*

tion granted by *state statute*. Had the legislature intended to limit the exemption to that required by the Federal Constitution there would have been no occasion whatever to go further than to say "There shall also be exempted all sales made to the United States." But the legislature intended to grant a greater exemption and made that intent clear . . . ' "

In *Knapp-Stiles, Inc., v. Michigan Department of Revenue, supra*, the court stated:

"At the outset, it may be noted that the question is *not* whether the State has the *power* to impose such tax upon contractors who are performing contracts with the United States.

" . . .

"Michigan has the power to impose such a tax. Has it done so? Or has it, by the language of the statute, exempted the sales here involved from the tax? . . . "

In the *Green* and *Knapp-Stiles* cases, the result was determined by interpreting a state exemption statute much broader than our own, for which reason the cases are distinguishable.

[5] The mortgagor-builder corporate entity created for the purpose of constructing and financing Capehart housing serves a separate and distinct function from that of the United States. That such a corporation is not an agency of the United States is sustained by the following decisions:

In *In re S. S. Silberblatt, Inc., v. Tax Commission of the State of New York, supra*, the New York Court of Appeals held that the mortgagor-builder corporation

was subject to that state's mortgage recording tax, stating (p. 641):

"The appellant's contention that this petitioner and the five corporate mortgagors are instrumentalities of the Federal Government or its agencies and, as such, are exempt from State and local taxation, is without substance. . . . At the time of the execution, delivery and recording of these mortgages, each of the mortgagors was a private corporation, all of the capital stock of which was privately owned. They were created for a commercial purpose for private profit, as distinguished from a governmental purpose. In the absence of statute to the contrary, it may not be assumed that a governmental function was involved. They possess all of the requisites and responsibilities of corporate existence and, as such, *are an entity separate and apart from the United States* (*United States v. Strang*, 254 U.S. 491) *and this is so, notwithstanding the fact that all of the capital stock of each corporation will ultimately be owned by the Federal Government* (*Sloan Shipyards v. United States Fleet Corp.*, 258 U.S. 549, 42 S.Ct. 386, 66 L.Ed. 762) . . ." (Italics ours)

In *United States v. Ft. George G. Meade Defense Housing Corp. No. 1*, D.C., 186 F.Supp. 639 (1960), it was held that the leasehold interest acquired by the mortgagor-builder corporation from the United States was subject to the Maryland mechanics' lien law because

" . . . the so-called Capehart Act contemplates leaving the entire arrangement for the financing and construction of Capehart housing projects in the hands of

private enterprise until the point at which the government has secured the capital stock of the Housing Corporation . . . "

The reasoning in the following cases, although not arising from Capehart transactions, supports the view that the mortgagor-builder corporations are not agencies of the government.

In *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn. (2d) 339, 267 P.(2d) 667 (1954), it was contended that the Du Pont Company was an agent or instrumentality of the United States in its operation of the Hanford Engineer Works. We held (pp. 349, 350):

" . . . the fact that the government reserved and exercised the right to restrict or control the action of the contractor as to its general activities does not establish the existence of an agency relationship. . . .

" . . .

"It is also without significance that all of the real and personal property utilized in performing the contract was owned by the government. [Citing cases.] The same is true with regard to the fact that the government exerted unusual supervisory controls over every phase of the contractor's activity. [Citing case.]"

In *United States v. Brown*, D.C., 41 F.Supp. 838 (1941), the contention was rejected that certain Regional Agricultural Credit Corporations, created pursuant to federal enactment, were immune from state taxation because the United States owned all of the capital stock of the corporations. The court said (p. 840):

"Whether or not these Regional Corporations shall enjoy sovereign immunity from taxation is wholly a

question of Congressional intent. They are purely commercial corporations exercising no sovereign function. In the absence of statutory provision, there is no reason why they should be exempted from taxation, especially in view of Congressional policy concerning this type of corporation, evidenced by many statutory provisions expressly subjecting the real property of similar corporations to taxation.

"The mere fact that the United States owns all the capital stock of these corporations is not alone sufficient to endow them with sovereign immunity, nor do they acquire such immunity merely because they are the medium through which the Government carries out certain proprietary activities. Note, 83 L.Ed. 799 et seq.

" . . .

"When a corporation is created for commercial as distinguished from Governmental purposes, it is ordinarily implied in the absence of statutory provisions to the contrary, that such corporation shall have all the requisites and responsibilities of corporate existence, even though the United States owns all the stock. Such a corporation is an entity separate from the United States. *United States v. Strang*, 254 U.S. 491, 41 S.Ct. 165, 65 L.Ed. 368."

We conclude that the mortgagor-builder corporation, having served an independent and distinct purpose in the taxable event, is not a federal agency.

Further, Congress has not expressed a legislative intent to immunize a Capehart corporation from state taxation. The invitations to bid expressly provided:

"Nothing in this Invitation for Bids shall be deemed

to relieve the eligible builder of any liability for the payment of sales or use taxes properly levied."

For the reasons stated, the sales tax was "properly levied" upon these transactions. Appellants, under the statute, were obligated to collect the tax from the mortgagor-builder corporations. Having failed to collect it, appellants are liable for the tax. RCW 82.08.050, *supra*.

The judgments are affirmed.

FINLEY, ROSELLINI, HAMILTON, and HALE, JJ., concur.

HUNTER, J. (dissenting)—The majority say that the sales tax must fall upon the person legally obligated to pay for construction of the military housing. With this I agree.

The majority then state that, by the express terms of the contract with the mortgagor-builder, the Delaware corporation, and not the United States was legally obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. The fact that the ultimate economic burden of the tax may fall upon the United States does not constitute it as the person legally obligated to pay the tax. Neither do I disagree with this rationale.

It is my disagreement with the majority in the disposition of the issue relating to whether the mortgagor-builder corporation is an instrumentality of the United States that bring me to a result contrary to that of the majority in this case.

Under the established rule for the construction of contracts, a contract must be picked up by its four

corners and considered in its entirety. In so doing, it is inescapable to conclude other than that the prime purpose of the housing contract was the construction of military housing for the exclusive use of the United States. It was necessarily the obligation of the government to pay for this housing and, although it did not wish to be directly obligated, the United States, in causing the Delaware corporation to be organized, did so to provide a means to carry out its obligation to compensate the contractors for the construction of this housing.

In *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923), it was held that a corporation created for the purpose of operating a sawmill and railroad for the promotion of the war-effort and wholly owned by the United States was an instrumentality of the United States. The court there said:

"In short the Spruce Production Corporation was organized by the United States an an instrumentality for carrying on the war, all its property was conveyed to it by or bought with money coming from the United States and *was used by it solely as means to that end*, and when the war was over it stopped its work except so far as it found it necessary to go on in order to wind up its affairs. . . .

" . . .

"The State claims the right to tax on the ground that taxation of the agency may be taxation of the means employed by the government and invalid upon admitted grounds, but that taxation of the property of the agent is not taxation of the means. We agree that it

'is not always, or generally, taxation of the means,' as said by Chief Justice Chase in *Thomson v. Pacific Railroad*, 9 Wall 579, 591. But it may be, and in our opinion clearly is when as here not only the agent was created but all the agent's property was acquired and used, for the sole purpose of producing a weapon for the war. *This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account. The incorporation and formal erection of a new personality was only for the convenience of the United States to carry out its ends. . . .* " (Italics mine.)

Contemporaneous with the signing of the housing contract, the stock of the corporation in the instant case was irrevocably placed in escrow, together with the resignation of the officers and directors, to be delivered to the United States at the conclusion of the construction of the housing. There was no possible contingency for the return of the stock to the stockholders or the documents of resignation to the officers and directors. The corporation owned nothing of any value in the housing being constructed. It served solely as a means to the end of obtaining military housing for the United States. There was no possibility for it to engage in any purpose other than to serve the end of obtaining military housing for the United States on this exclusive project. Because it had no purposes independent of those of the United States, the corporation was nothing more than an instrumentality thereof.

The appellants cite *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958), which is persuasive

of their contention. There, under the authority of the Capehart Act, the government entered into a contract virtually identical with that of the instant case for the construction of military housing at the Eglin Air Force Base in Florida. The Florida court in effect found that the Delaware corporations were government instrumentalities, stating:

" 'The AFB corporations were created at the direction of the United States for the sole purpose of borrowing money to be expended in constructing facilities needed by the United States, to be repaid by the United States and further securing the payment of this money by a mortgage upon property of the United States. These corporations will continue in existence until the mortgage debts are paid, so as to provide a party against whom the mortgages may be foreclosed in the remote contingency that the United States defaults in its obligation to pay the mortgage debt.

" 'Even if we regard the AFB corporation as private enterprises, their interest in the property is so neglible —lessees without right of use or possession—as to make it entirely unrealistic to hold that it destroys the status of these buildings as a part of the public works of the United States.

" 'It is very doubtful if these corporations should be regarded as anything other than agencies or instrumentalities of the Federal Government. In *Clallam County, Wash. v. United States*, 263 U.S. 341, 44 S.Ct. 121, 68 L.Ed. 328, the Supreme Court held that a corporation created for the purpose of operating a sawmill and railroad in the promotion of the war ef-

fort during the first World War and which was wholly owned by the United States was an agency of the United States and that its property was, therefore, immune from state taxation. In describing the corporation there involved the [sic] used language peculiarly applicable to each AFB corporation: "The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends." The creation of the AFB corporations was only for the convenience of the United States to enable it to finance military construction in a manner determined by the Congress to be most conducive to the national interest. . . . ' "

The limited function of the Delaware corporation, its power and purpose are aptly stated by the Michigan court in *Knapp-Stiles, Inc., v. Michigan Department of Revenue*, CCH 2 Mich. Tax Cases ¶ 200-202 (1962). There, as here, the contracts were for military housing under the Capehart Act. The court said relative to the corporations:

" . . . In the Invitation for Bids, which is prepared and issued by the United States, acting through the Department of the Air Force, there is found in Paragraph 1, above quoted, the following:

" 'The statute further contemplates that the Government-owned housing site be leased to a mortgagor or borrower corporation *which will act as a channel* for the proceeds of the mortgage loan from the lender to the successful bidder . . . '

"And a review of the documents—the lease, the contract, and the mortgage is convincing that this is sub-

tantially the only function that the Delaware corporation do perform.

"They have no real powers except to do the bidding of the United States. . . .

" . . .

"The corporations do not determine the terms of the contract. That is all done before the corporations come into existence. They do not determine whether the contract has been performed. They cannot modify its terms. They cannot terminate it.

"True, the corporations had a lease upon the premises. While this is nominally for a fifty-five year term, in fact, the actual possession, maintenance and operation of the housing is in the hands of the United States and its Air Force as soon as the housing is ready for occupancy.

"The United States alone determines the terms of the contract. It alone can modify or terminate it. It alone determines when it has been performed."

An analysis of *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), cited by the majority, discloses that the opinion is based on the erroneous premise that the Delaware corporations were " . . . created for a commercial purpose for private profit, as distinguished from a governmental purpose." As heretofore stated, consideration of the housing contract in its entirety cannot support such a conclusion. The analysis of the housing contract and the reasoning of the dissent in the *Silberblatt* case is correct.

"... Although under our State law the tax is imposed upon the recording of the mortgage (*Franklin Soc. v. Bennett*, 282 N.Y. 79), this case is controlled by Federal law under which the tax is on the mortgage itself, which is a Federal instrumentality exempt from State taxation (*Federal Land Bank v. Crosland*, 261 U.S. 374; ...). Unlike the Wherry Act, the Capehart Act, under which this military housing project was authorized, renders petitioner-appellant merely a builder and not a private sponsor of the military housing. The United States, through its Department of Defense, is the sponsor, financier and owner of the entire project. The mortgagor corporations are mere fictions, and they and the mortgagee banks had no other function in this business than to act as agents for the Federal Government (*Clallam County v. United States*, 263 U.S. 341, 345, 44 S.Ct. 121, 68 L.Ed. 328; *Railroad Co. v. Peniston*, 18 Wall 5, 42, 85 U.S. 5, 42, 21 L.Ed. 787) ..."

The majority attempt to distinguish the *Clallam County* case on the basis that the corporation there had no purpose other than to produce war materials for the United States government, and it quotes from the *Clallam County* case as follows:

"... This is not like the case of a corporation having its own purposes as well as those of the United States...."

The inference from this quotation which is desired by the majority is that the Delaware corporation had purposes other than those of the United States government. This is erroneous and unsupported by the record.

The holding of the cases cited by the majority, ***E. I. Du Pont de Nemours & Co. v. State***, 44 Wn.(2d) 339, 267 P.(2d) 667 (1954), and *United States v. Brown*, 41 F.Supp. 838 (1941), is not inconsistent with the *Clallam County* case since the corporations, in those cases, were not instrumentalities of the United States because they had separate commercial purposes for private profit.

In the instant case we should hold that, although the mortgagor-builder is the "buyer" to whom the retail sale of the housing project construction was made, it was nothing more than an instrumentality of the United States government; that it had no commercial purpose other than for the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the federal government applies.

The judgment of the trial court should be reversed, and the cause remanded with instructions to enter judgment restraining the Tax Commission from imposing the tax and to permit recovery of the tax which appellants paid under protest.

HILL, DONWORTH, and WEAVER, JJ., concur with HUNTER, J.

APPENDIX B

STATUTES INVOLVED

Revised Code of Washington

RCW 82.08.010 Definitions. For the purposes of this chapter:

(1) "Selling price" means the consideration, whether money, credits, rights, or other property, expressed in the terms of money paid or delivered by a buyer to a seller, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer;

(2) "Seller" means every person making sales at retail or retail sales to a buyer or consumer, whether as agent, broker, or principal;

(3) "Buyer" and "consumer" include, without limiting the scope hereof, every individual, receiver, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise, municipal corporation, quasi municipal corporation, and also the state, its departments and institutions and all political subdivisions thereof, irrespective of the nature of the activities engaged in or

functions performed, and also the United States or any instrumentality thereof;

(4) The meaning attributed in chapter 82.04 to the terms "tax year," "taxable year," "person," "company," "sale," "sale at retail," "retail sale," "sale at wholesale," "wholesale sale," "business," "engaging in business," "cash discount," "successor," "consumer," "in this state" and "within this state" shall apply equally to the provisions of this chapter. . . .

RCW 82.08.020 Retail sales tax imposed. There is levied and there shall be collected a tax on each retail sale in this state equal to three and one-thfrd per cent of the selling price: *Provided*, That from April 1, 1959 the tax imposed by this section shall be equal to four per cent of the selling price. The tax imposed under this chapter shall apply to successive retail sales of the same property and to the retail sale of intoxicating liquor by the Washington state liquor stores. . . .

RCW 82.08.030 Exemptions. The tax hereby levied shall not apply to the following sales:

(1) Casual and isolated sales of property or service, unless made by a person who is engaged in a business activity taxable under chapters 82.04., 82 16 or 82.28: *Provided*, That the exemption provided by this paragraph shall not be construed as providing any exemptio nfrom the tax imposed by chapter 82.12;

(2) Sales made by persons in the course of business activities with respect to which tax liability is specifically imposed under chapter 82.16, when the gross proceeds from such sales must be included in the measure of the tax imposed under said chapter;

(3) The distribution and newsstand sales of newspapers;

(4) Sales which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(5) Sales of motor vehicle fuel used in aircraft by the manufacturer thereof for research, development, and testing purposes and sales of motor vehicle fuel taxable under chapter 82.36: *Provided,* That the use of any such fuel upon which a refund of the motor vehicle fuel tax has been obtained shall be subject to the tax imposed by chapter 82.12;

(6) Sales (including transfers of title through decree of appropriation) heretofer or hereafter made of the entire operating property of a publicly or privately owned public utility, or of a complete operating integral section thereof, to the state or a political subdivision thereof for use in conducting any business defined in subdivisions (1), (2), (3), (4), (5), (6), (7), (8), (9), (10) or (11) of RCW 82.16.010;

(7) Auction sales made by or through auctioneers of tangible personal property (including household goods) which have been used in conducting a farm activity, when the seller thereof is a farmer and the sale is held or conducted upon a farm and not otherwise;

(8) Sales to corporations which have been incorporated under any act of the congress of the United States and whose principal purposes are to furnish volunteer aid to members of armed forces of the United States and also to carry on a system of national and international relief and to apply the same in mitigat-

ing the sufferings caused by pestilence, famine, fire, floods, and other national calamities and to devise and carry on measures for preventing the same;

(9) Sales of purebred livestock for breeding purposes where the animals are registered in a nationally recognized breed association; sales of cattle and milk cows used on the farm;

(10) Sales of tangible personal property (other than the type referred to in subdivision (11) hereof) for use by the purchaser in connection with the business of operating as a private or common carrier by air, rail, or water in interstate or foreign commerce: *Provided*, That any actual use of such property in this state shall, at the time of such actual use, be subject to the tax imposed by chapter 82.12;

(11) Sales of airplanes, locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state; also sales of tangible personal property which becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers used by the holder of a carrier permit issued by the Interstate Commerce Commission authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; also sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving;

(12) Sales of motor vehicles and trailers to be used for the purpose of transporting therein persons or property for hire in interstate or foreign commerce: *Provided*, That the purchaser must be the holder of a carrier permit issued by the Interstate Commerce Commission and that the vehicles will first move upon the highways of this state from the point of delivery in this state to a point outside of this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100;

(13) Sales of motor vehicles and trailers to nonresidents of this state for use outside of this state, even though delivery be made within this state, but only when (a) the vehicles or trailers will be taken from the point of delivery in this state directly to a point outside this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100, or (b) said motor vehicles and trailers will be registered and licensed immediately under the laws of the state of the purchaser's residence, will not be used in this state more than three months, and will not be required to be registered and licensed under the laws of this state.

(14) Sales to nonresidents of this state for use outside of this state of tangible personal property which becomes a component part of any machinery or other article of personal property belonging to such nonresident, in the course of installing, repairing, cleaning, altering, or improving the same and also sales of or charges made for labor and services rendered in respect to any installing, repairing, cleaning, altering, or

improving, of personal property of or for a nonresident, but this subsection (14) shall apply only when the seller agrees to, and does, deliver the property to the purchaser at a point outside this state, or delivers the property to a common or bona fide private carrier consigned to the purchaser at a point outside this state;

(15) Sales to nonresidents of this state for use outside of this state of watercraft requiring coast guard registration or registration by the state of principal use according to the Federal Boating Act of 1958, even though delivery be made within this state, but only when (a) the watercraft will not be used within this state for more than forty-five days and (b) an appropriate exemption certificate supported by identification ascertaining residence as provided by the tax commission and signed by the purchaser or his agent establishing the fact that the purchaser is a non-resident and that the watercraft is for use outside of this state, one copy to be filed with the tax commission with the regular report and a duplicate to be retained by the dealer.

(16) Sales of baby chicks and turkey poults for use in the production for sale of poultry or poultry products.

(17) Sales to nonresidents of this state for use outside of this state of machinery and implements for use in conducting a farming activity, when such machinery and implements will be transported immediately outside the state. As proof of exemption, an affidavit or certification in such form as the tax commission shall require shall be made for each such sale, to be retained as a business record of the seller.

(18) Sales for use in noncontiguous states, territories and possessions of the United States, but only when, as a necessary incident to the contract of sale, the seller delivers the subject matter of the sale to the purchaser or his designated agent at the usual receiving terminal of the carrier selected to transport the goods, under such circumstances that it is reasonably certain that the goods will be transported directly to a destination in such noncontiguous states, territories and possessions. . . .

* * *

RCW 82.08.050 Buyer to pay, seller to collect tax—Penalties. The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections adopted by the tax commission pursuant to the provisions of RCW 82.08.060. The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the commission, and any seller who appropriates or converts the tax collected to his own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter shall be guilty of a misdemeanor.

In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the commission in the manner prescribed by this chapter, whether such failure is the result of his own acts or the result of acts or conditions beyond his control, he

shall, nevertheless, be personally liable to the state for the amount of the tax.

The amount of tax, until paid by the buyer to the seller, or to the commission, shall constitute a debt from the buyer to the seller and any seller who fails or refuses to collect the tax as required with intent to violate the provisions of this chapter or to gain some advantage or benefit, either direct or indirect, and any buyer who refuses to pay any tax due under this chapter shall be guilty of a misdemeanor.

Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the commission, the commission may, in its discretion, proceed directly against the buyer for collection of the tax, in which case a penalty of ten percent may be added to the amount of the tax for failure of the buyer to pay the same to the seller, regardless of when the tax may be collected by the commission; and all of the provisions of chapter 82.32, including those relative to interest and penalties, shall apply in addition; and, for the sole purpose of applying the various provisions of chapter 82.32, the fifteenth day of the month following the bimonthly tax period in which the purchase was made shall be considered as the due date of the tax. . . .

RCW 82.08.060 Collection of tax — Methods and schedules. The tax commission shall have power to adopt rules and regulations prescribing methods and schedules for the collection of the tax required to be collected by the seller from the buyer under this chapter. The methods and schedules prescribed shall be

adopted so as to eliminate the collection of fractions of one cent and so as to provide that the aggregate collections of all taxes by the seller shall, insofar as practicable, equal the amount of tax imposed by this chapter. Such schedules may provide that no tax need by collected from the buyer upon sales below a stated sum and may be amended from time to time to accomplish the purposes set forth herein. . . .

* * *

RCW 82.08.140 Administration. The provisions of RCW 82.04.470 and all of the provisions of chapter 82.32 shall have full force and application with respect to taxes imposed under the provisions of this chapter. . . .

"SALE DEFINED

RCW 82.04.040 "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. It also includes the furnishing of food, drink, or meals for compensation whether consumed upon the premises or not.

"Casual or isolated sale" means a sale made by a person who is not engaged in the business of selling the type of property involved.

"SALE AT RETAIL," "RETAIL SALE" DEFINED

RCW 82.04.050 "Sale at retail" or "retail sale" means every sale of tangible personal property (including articles produced, fabricated, or imprinted) other than a sale to one who (a) purchases for the purpose of resale as tangible personal property in the regular course of business, or (8) installs, repairs, cleans, alters, imprints, improves, constructs, or decorates real or personal property of or for consumers, if such tangible personal property becomes an ingredient or component of such real or personal property, or (c) purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. The term also means every sale of tangible personal property to persons engaged in any business which is taxable under RCW 82.04.280, subsection (2), and 82.04.290.

The term "sale at retail" or "retail sale" shall include the sale or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following: (a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers, excluding, however, services rendered in respect to live animals, birds and insects; (b) the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above

real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include the sale of services or charges made for tue clearing of land and the moving of earth, excepting the mere leveling of land used in commercial farming or agriculture; (c) the sale of or charge made for labor and services rendered in respect to the cleaning, fumigating, razing or moving of existing buildings or structures, but shall not include the charge made for janitorial services; (d) the sale of or charge made for labor and services rendered in respect to automobile towing, armored car service and similar automotive transportation services, but not in respect to those required to report and pay taxes under chapter 82.16; (e) the sale of and charge made for the furnishing of lodging and all other services by a hotel, rooming house, tourist court, motel, trailer camp, and the granting of any similar license to use real property, as distinguished from the renting or leasing of real property, and it shall be presumed that the occupancy of real property for a continuous period of one month or more constitutes a rental or lease of real property and not a mere license to use or enjoy the same.

The term shall not include the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any publicly owned street, place, road, highway, bridge, or trestle which is used for to be used primarily for foot or vehicular traffic, nor shall it include sales of feed, seed, fertilizer,

and spray materials to persons for the purposes of producing for sale any agricultural product whatsoever, including milk, eggs, wool, fur, meat, honey, or other substances obtained from animals, birds, or insects.

"SALE AT WHOLESALE," "WHOLESALE SALE" DEFINED

RCW 82.04.060 "Sale at wholesale" or "wholesale" sale" means any sale of tangible personal property which is not a sale at retail and means any charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers: *Provided,* That the the term "real or personal property" as used in this section shall not include any natural products named in RCW 82.04.100.

"GROSS PROCEEDS OF SALES" DEFINED

RCW 82.04.070 "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

"CONSUMER" DEFINED

RCW 82.04.190 "Consumer" means the following:

(1) Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property other than for the purpose (a) of resale as tangible

personal property in the regular course of business or (b) of incorporating such property as an ingredient or component of real or personal property when installing, repairing, cleaning, altering, imprinting, improving, constructing, or decorating such real or personal property of or for consumers or (c) of consuming such property in producing for sale a new article of tangible personal property or a new substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale;

(2) Any person engaged in any business activity taxable under RCW 82.04.290;

(3) Any person engaged in the business of contracting for the building, repairing or improving of any publicly owned street, place, road, highway, bridge or trestle which is used or to be used primarily for foot or vehicular traffic as defined in RCW 82.04.280, in respect, however, only to tangible personal property used or consumed in such business;

(4) Any person who is an owner, lessee or has the right of possession to or an easement in real or personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business, excluding only the United States, the state, and its political subdivisions in respect to labor and services rendered to their real property which is used or held for public road purposes.

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In the Supreme Court of the United States

OCTOBER TERM, 1963-4

No. 850

HEBB & NARODICK CONSTRUCTION CO., INC. and GENERAL CONSTRUCTION CO., joint venturers, doing business as HEBB & NARODICK CONSTRUCTION CO., INC., & ASSOCIATES, *Appellant*,

vs.

THE STATE OF WASHINGTON and WILLIAM S. SCHUMACHER, CLARK SQUIRE and A. E. HANKINS, as the Tax Commission of the State of Washington, *Appellees*.

No.....

HEBB & NARODICK CONSTRUCTION CO., INC., a Washington corporation, *Appellant*,

vs.

THE STATE OF WASHINGTON and WILLIAM S. SCHUMACHER, CLARK SQUIRE and A. E. HANKINS, as the Tax Commission of the State of Washington, *Appellees*.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

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THE ARGUS PRESS, SEATTLE, WASHINGTON

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ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

A single Jurisdictional Statement is being filed covering both cases appearing on the title page, pursuant to Rule 15(3), for the reason that the two cases are appealed from the same court, and involve identical

questions. The first listed case involves the construction of military housing at Fort Lewis, Washington. The second listed case involves the construction of military housing at Fairchild Air Force Base at Spokane, Washington. All facts referred to herein will be taken from the record in the first listed case, as will all page references to the record.

A. OPINION BELOW

The opinion of the Supreme Court of the State of Washington is reported in — Wn.(2d) —, 384 P.(2d) 337. A copy of the opinion is attached hereto as Appendix A.

B STATEMENT OF GROUNDS

(1) Appellant instituted action to recover retail sales taxes paid under protest, and to enjoin the State of Washington from collecting further retail sales taxes assessed against appellants in connection with the construction of military housing on a military reservation under a contract with the United States, entered into pursuant to the provisions of the Act of Congress popularly known as the Capehart Act. The action was brought under Revised Code of Washington 82.32-180 and 82.32.150.

(2) The judgment of the Supreme Court of the State of Washington was entered on August 1, 1963. The order denying appellants' petition for rehearing was entered September 26, 1963. Notice of appeal was filed in the Supreme Court of the State of Washington on December 20, 1963.

(3) The jurisdiction of the Supreme Court of the

United States to review this judgment by appeal is conferred by Title 28, U.S.C. Sec. 1257(2).

(4) The following decisions sustain the jurisdiction of the Supreme Court to review the judgment in this case on appeal:

Kern Limerick, Inc. v. Scurlock, 340 U.S. 110, 98 L.Ed. 546, 74 S.Ct. 403;

U.S. v. Boyd, Supreme Court Docket No. 1157;

General Motors Corp. v. Washington, Supreme Court Docket No. 1071;

Livingston v. U.S., 179 F.Supp. 9, 364 U.S. 281, 4 L.Ed.(2d) 1719, 80 S.Ct. 1611;

James v. United Artists Corp., 305 U.S. 410, 83 L.Ed. 256, 59 S.Ct. 272;

Gwinn, White & Prince v. Henneford, 205 U.S. 434, 83 L.Ed. 272, 59 S.Ct. 325.

(5) The State statutes involved are Revised Code of Washington Sections 82.04.040, 82.04.050, 82.04.060, 82.04.190, 82.08.010, 82.08.020, 82.08.030, 82.08.050.

The above are set forth in Appendix B.

C. QUESTION PRESENTED BY THIS APPEAL

The following question is presented by this appeal:

Public quarters owned and operated by the United States are constructed for the United States on a military reservation, pursuant to the provisions of the Capehart Act (42 U.S.C.A. Sec. 1594a *et seq.*). Is the Washington State retail sales tax statute, as construed and applied by the Supreme Court of the State, repugnant to the Constitution and laws of the United States, in that it imposes a state sales tax on the United

States or its instrumentality based upon the cost of such construction to the United States, in violation of the immunity of the United States and its instrumentalities from state taxation?

In the State of Washington, the retail sales tax is imposed by statute on the buyer or consumer, and not on the seller. The statute requires the seller merely to collect the sales tax on behalf of the State, and pay it over to the State (Revised Code of Washington 82.08-.050). It was stipulated in the pre-trial order that when the appellant contractor submitted its bid to the United States, it did not include sales tax as an item of cost, or collect sales tax. The State's assessment against the appellant contractor is based squarely upon the claim that the contractor should have collected sales tax as agent of the State, but failed to do so.

As will be demonstrated, the buyer or consumer of the military housing owned and operated by the Army can only be the United States or its instrumentality. The Washington State Supreme Court held that sales tax should have been collected by appellant.

Thus, the Washington State retail sales tax statute, as construed and applied by the Supreme Court of the State of Washington, is repugnant to the Constitution and laws of the United States, in that is does impose the state sales tax on the United States or its instrumentality, in violation of its constitutional immunity from State taxation.

D. (1) STATEMENT OF THE CASE

A "Capehart" military housing project for the U.S. Army is initiated and completed as follows:

The Secretary of the Army determines that the Army requires military housing facilities on a military reservation. Plans and specifications are prepared by the Army Engineers. The United States calls for bids. The contractor submits its bid to the United States accompanied by the required $25,000.00 bid deposit. The bid of the successful contractor is accepted by the United States, in the form of a document entitled "Letter of Acceptability," given to the contractor by the Secretary of the Army (Ex. 3, R. 13-14).

Construction takes place under the supervision of the Army (Ex. 8, Pages HC-7, 8, 14). As each separate military housing unit is completed, the contractor is required to place it "under the control of the Department (of the Army)," and the United States is required at all times to "maintain and operate at its own cost and expense such individual housing unit as public quarters" (Ex. 8, p. HC-7).

The contract with the contractor contains all clauses which Federal law requires in every contract with the United States for the construction of Federal Public Works, such as: Buy American Act, Officials of Congress Not to Benefit, Covenant Against Contingent Fees, Prohibition of Convict Labor Act, Nondiscrimination in Employment Act, Davis-Bacon Act (requiring payment of prevailing wages as determined by the Secretary of Labor), Eight-Hour Day on Public

Works Act, Anti-Kickbacks from Public Works Employees Act, Renegotiation Act, and others (Ex. 8).

In the "Invitations for Bids" (Ex. 1, p. 16), the United States describes the project as follows:

> "The Housing Contract provides *for the construction of Government quarters*, and therefore, no inspection fees or approvals by municipal or other governmental authorities will be required."

THE ONLY DIFFERENCE BETWEEN A CAPEHART MILITARY PROJECT AND ANY OTHER PROJECT BEING BUILT FOR THE FEDERAL GOVERNMENT, IS IN THE METHOD BY WHICH THE UNITED STATES CHOOSES TO PAY FOR THE CONSTRUCTION (Ex. 1).

The method by which the United States pays for the construction is this:

The United States requires that a Delaware corporation be formed. It requires that this corporation execute and deliver a promissory note to a lending agency for the amount of the contract price of the construction. The promissory note is payable in installments (Ex. 9). *It is provided that the United States, and not the corporation, will pay the installments as they become due* (Ex. 16). With the proceeds of this note, the contractor is paid the contract price for the construction of the military housing for the United States (Ex. 1, 3, 4, 9).

This is the method of financing used by the United States for the construction of military housing under the Capehart Act generally, and is the method of financing used by the United States for the construction

of the military housing on Fort Lewis in the instant case.

Since the funds are by this method acquired through private lending institutions, the United States avoids charging the cost of construction against the national budget in the year of commitment. It also obtains for the United States the privilege of paying the installment note from annual appropriations.

The United States also requires the execution of a mortgage in connection with borrowing the money to pay for construction. The reason is this: Many institutions which lend or invest their funds can only do so on the security of mortgages. These include pension or retirement trusts, insurance companies, and the like. The restrictions limiting their investments to mortgages are contained in their charters, or their state law.

Some institutions are permitted to loan only on F.H.A. insured mortgages.

Therefore, in order to enable such institutions to invest their funds in the construction of military housing, the method which the United States has created for the payment by it of the promissory note, also includes a "mortgage." Because of the nature of the security, the mortgage is one in name only—an illusory mortgage.

In order to create the illusion of a "mortgage," the following sequence of events is required by the United States.

In an opinion dated October 22, 1959, rendered by

the Attorney General of the United States to the Secretary of Defense, it is stated:

> "The actual operation of the Capehart Act is extremely complex. Indeed, it has been characterized as a jig-saw puzzle on the floor of the Senate."

The sequence of events is required by the United States in the contract created by the contractor's *offer* (his "Bid," Ex. 2), and the *acceptance* of the United States (its "Letter of Acceptability" Ex. 3).

The exact text of each document hereinbefore and hereinafter referred to, is prescribed and required by the United States (R. 18).

The requirements of the United States are these:

(1) That the contractor cause to be incorporated a Delaware corporation (Ex. 1, p. 4).

(2) That the corporation be capitalized for $1,000.00 —100 shares at $10.00 each (Ex. 1, p. 4).

(3) That the contractor subscribe for all of the stock (Ex. 1, p. 4).

(4) That the contractor elect officers and directors (Ex. 1).

(5) That the stock certificate be endorsed in blank by the contractor (Ex. 1).

(6) That the officers and directors of the corporation sign resignations (Ex. 11).

(7) That the endorsed stock certificate and the resignations be placed in irrevocable escrow (Ex. 11).

(8) That the terms of the escrow be that these documents shall be delivered to the Secretary of the Army

of the United States, immediately upon completion of construction (Ex. 11).

(9) That at the same time the resignations and stock are placed in escrow for the United States, the Secretary of the Army execute a document entitled "Lease" to the Delaware corporation (Ex. 6).

(10) That this "lease" be of the land owned by the United States, on which the military housing is to be erected (Ex. 6).

(11) That the corporation turn over to the Army, as the stated consideration for the "lease," the $1,000.00 paid to the corporation for the purchase of its capital stock (Ex. 1).

(12) That a document entitled "Department of the Army Housing Contract" be signed by the following: The United States, the contractor, and the Delaware corporation (Ex. 8).

(13) *That these documents provide that the lessor, rather than the lessee, has the exclusive right of possession of the leased ground during the entire term of the lease!* (Ex. 8, p. HC-7).

(14) That the Delaware corporation execute and deliver a promissory note, payable in installments, to some lending institution (Ex. 9).

(15) That the installment note be in a sum equal to the amount of the contractor's successful Bid, previously accepted by the United States (Ex. 1).

(16) *That the United States execute a document in which it is agreed that the United States, rather than*

the Delaware corporation, will pay the promissory note (Ex. 16).

(17) That the Delaware corporation execute and deliver a document entitled "Mortgage," to "secure" the promissory note which the United States has agreed to pay (Ex. 10).

(18) That the mortgaged property be not the land, or the buildings to be erected, but only the Delaware corporation's non-existent leasehold interest (Ex. 10).

(19) That the F.H.A. agree in advance to insure the note and "mortgage" immediately upon completion of construction (Ex. 5).

(20) That the contractor construct the military housing in accordance with its accepted Bid to the United States (Ex. 1).

(21) That the lending agency use the proceeds of the loan represented by the promissory note to pay the contractor for the construction of the military housing (Ex. 3).

(22) That progress payments and final payment to the contractor be made only with the approval of the United States (Ex. 8, p. HC-3).

(23) That the documents provide that during the entire term of the illusory "lease," the lessee Delaware corporation is *prohibited from occupancy* of the leased premises, and that during the term of the "lease" the lessor United States "*shall maintain and operate at its own cost and expense such individual housing units as Public Quarters*" (Ex. 8, p. HC-7).

* * *

The following nomenclature is used in the documents:

The contractor is called "Eligible Builder."

The figurehead Delaware corporation is called "Mortgagor-Builder."

The document in which the United States agrees that it will pay the installment note executed by the figurehead corporation is entitled "Guaranty" (Ex. 16).

The so-called "Guaranty" is not a guaranty, but is a direct statement that the United States, rather than the figurehead corporation, will pay the loan. This document states:

> "This guaranty, executed this 12 day of May, 1958, by the UNITED STATES OF AMERICA (hereinafter called the 'Department') represented by the Secretary of the Army (hereinafter called the 'Secretary'),
> WITNESSETH:
>
> " * * * The Department will, subject to the conditions stated in the foregoing guarantee, *make each periodic payment becoming due to the mortgagee on said note in accordance with the terms thereof* WITHOUT ANY REQUIREMENT THAT THE MORTGAGEE SHALL HAVE MADE A PRIOR DEMAND TO THE MORTGAGOR-BUILDER (the figurehead corporation) FOR SUCH PAYMENT."

NOTE: The Attorney General of the United States on October 22, 1959, rendered an opinion to the Secretary of Defense, in part as follows:

> "See also * * * 105 Congressional Record A 4156 pointing out * * * that a guaranteed mortgage

constitutes a 'truly direct obligation' of the United States." * * *

"I conclude that Congress has the power to authorize the Secretary to guarantee Armed Services Housing mortgages * * * My conclusion that the Secretary's loan guaranty under Sec. 403 (c) of the act constitute a valid obligation of the United States is fully supported by pertinent congressional statements."

On page 2 of Exhibit 1, "Invitation for Bids," the United States describes this so-called "Guaranty" in the following words:

"Payment of the mortgage indebtedness of the mortgagor-builder is undertaken by the Department (of the Army)."

* * *

As stated, the illusory "mortgage" and the promissory note signed by the figurehead corporation, but payable directly by the United States, is also insured by the F.H.A. The reason for this is not that the direct obligation of the United States to pay the note is not a sufficiently sound security. The actual reason is stated by the Attorney General of the United States in the above described Opinion rendered to the Secretary of Defense, as follows:

"Two preliminary questions present themselves. First, why Congress provided for double protection: i.e., insurance by the (F.H.A.) Commissioner, and guaranty by the Secretary (of Defense) ... The duplication of insurance by the Commissioner and guaranty by the Secretary is based on the consideration that, while, basically, Armed Services Housing constitutes a responsibility of the Department of Defense, mortgages insured by the Federal

Housing Administration can be financed relatively easily because virtually all states have legislation making them legal investments for banks and similar institutions. The enactment of state legislation making mortgages insured or guaranteed by the Secretary legal investments throughout the nation, and thus generally acceptable to institutional investors, probably would have taken five years, to judge from past experience. In these circumstances it appeared desirable that Armed Services Housing mortgages should carry the customary insurance by the Federal Housing Commissioner as well as a guaranty by the Secretary of Defense."

* * *

The entire military housing project is not paid for through this round-about Capehart method. The documents provide that certain "improvements and utilities" shown on the plans and specifications are to be furnished by the United States, and not by the contractor. The United States enters into separate contracts with others to furnish these improvements and utilities, and pays for them directly.

> "Payments under such separate contracts will be made by the Department (of the Army) from sources other than mortgage proceeds."

Part of the project is thus paid for directly by the United States, in the usual way, and part of the project is paid from the proceeds of the note and "mortgage" signed by the figurehead corporation.

* * *

Even though all the buildings are to be built by one contractor, pursuant to one Bid made to and accepted

by the United States, there may be more than one Delaware corporation involved in the financing. This is because the amount involved may be too great for any one private institution to loan. In such cases, the United States allocates definite portions of the single contract price among two or more Delaware corporations. Except for the "Housing Contract" (Ex. 8), a full set of documents as above described are made and executed relating to each corporation.

Thus, in the instant case, the plaintiff contractor's bid accepted by the United States was approximately $6,000,000.00. The United States directed that three Delaware corporations be created, and that each one execute a promissory note for approximately $2,000,000.00. The United States then executed three separate documents in which it agreed that it, rather than these corporations, would pay the three notes. The sum of the three notes equalled the amount of the plaintiff's Bid which the United States had accepted (Ex. 1, p.3).

The "Housing Contract" (Ex. 8) shows clearly that the United States required the creation of the "mortgagor-builder" corporation, that the corporation is an instrumentality of the United States, a figurehead of the United States — in fact, to all intents and purposes it is the United States. The "Housing Contract" shows that the United States and the Contractor are the only parties in interest in either the "lease" or that contract. The contract is exactly the same as if the United States and the contractor were the only two parties named to the agreement.

The named parties to the "housing Contract" are:

(1) "THE UNITED STATES OF AMERICA, acting by and through the Department of the Army (hereinafter called "The Department") and represented by the Contracting Officer,"

(2) "HEBB & NARODICK CONSTRUCTION CO., INC. & ASSOCIATES (hereinafter called the 'eligible builder' or the 'Contractor'),"

(3) "ALC HOUSING INC. No. 1, ALC HOUSING INC. No. 2, and ALC HOUSING INC. No. 3, Delaware corporation (each and all of which are hereinafter referred to as the 'mortgagor-builder'),"

Following is a brief summary of some of the provisions of the "Housing Contract" and "Lease" not previously mentioned:

(1) The Housing Contract is entitled

> "DEPARTMENT OF THE ARMY HOUSING CONTRACT." (Ex. 8, p. 1)

(2) The first "Whereas" clause shows that it is the Army, not the figurehead corporation, which is contracting for housing:

> "Whereas, Title IV of the Housing Amendments of 1955, as amended * * * authorizes THE DEPARTMENT TO CONTRACT, ON THE BASIS OF COMPETITIVE BIDS, FOR THE CONSTRUCTION OF HOUSING * * * " (Ex. 8, p. 1)

(3) The "Lessee" is prohibited from ever occupying the leased property — either before or after construction (Ex. 8, p. HC-7; Ex. 6, p. 2).

(4) The "Lessee" is required to consent to giving the Army Lessor exclusive possession of the leased premises for the full term of the so-called lease, "with-

out charge or cost to the Department." The "Lessee" gets no compensation in return for giving the Army lessor the exclusive right of possession (Ex. 8, p. HC-7).

(5) The "Lessee" cannot engage in any other endeavor, on the leased premises, or elsewhere, because (a) its Articles of Incorporation prohibit it from engaging in any other endeavor, and (b) the "Lease" provides that the premises are "to be used solely for the purposes of constructing thereon an Armed Services Housing Project" (Ex. 6, p. 1).

(6) The "Lessee" has no voice in what is done with the leased premises, because the U.S. had already accepted the contractor's bid to construct a project on the entire leased premises in accordance with plans and specifications drawn by the U.S. (Ex. 2, Bid, and Ex. 3, Letter of Acceptability).

(7) The "Lessee" is prohibited from asking the bank to pay out any money to the contractor from the $6,000,000.00 note which it signed. The U.S. has the sole voice in that respect (Ex. 8, p. HC-3).

(8) The figurehead corporation is prohibited from entering into any agreement with the contractor (Ex. 8, p. HC-5).

(9) The "Lessee" is "required" to sign whatever form of Building Loan Agreement is acceptable to the U.S. (Ex. 8, p. HC-8).

(10) Even personal property which the contractor is required to furnish — which never becomes part of the real estate — belongs to the U.S., rather than the "Lessee," and the "Lessee" is prohibited from using the same during the term of the lease (Ex. 8, p. HC-9).

(11) The U.S. has the right to extend the time for completion of the project as long as it desires (Ex. 8, p. HC-16).

(12) Any articles of property belonging to the contractor which he fails to remove from the leased premises when the job is completed, are deemed abandoned to the U.S. Lessor, rather than to the "Lessee" (Ex. 8, p. HC-20).

(13) It is specifically provided that whenever words "satisfaction," "required," "ordered," "acceptable," "approved," etc., are used, those words refer to the "satisfaction," "approval," etc., of the U.S., not of the figurehead (Ex. 8, p. HC-31).

(14) The "Determination of Completion" is made solely by the United States (Ex. 8, p. HC-7).

(15) The United States, not the figurehead, has the right to terminate the contract and assess liquidated or actual damages against the contractor (Ex. 8, p. HC-37).

(16) The figurehead corporation is specifically relieved of every single obligation nominally placed upon it by the Housing Contract, by a specific provision in the Housing Contract itself that all obligations of the figurehead shall be performed either by the United States or by the contractor (Ex. 8, p. 8, HC-9).

> *"The eligible builder shall bear all expenses * * * and guarantee the discharge of all duties of the mortgagor-builders * * * except * * * the obligations of the mortgagor-builders which the Department shall have guaranteed * * *."*

THUS, IN THE "HOUSING CONTRACT"

ITSELF, THE CONTRACTOR AND THE UNITED STATES AGREE THAT THERE IS NOT A SINGLE OBLIGATION PURPORTEDLY PLACED UPON THE FIGUREHEAD CORPORATION, WHICH IS NOT EITHER THE OBLIGATION OF THE CONTRACTOR, OR THE OBLIGATION OF THE UNITED STATES — PROVING BEYOND DISPUTE THAT THERE ARE ONLY TWO REAL PARTIES TO THIS "CONTRACT": THE CONTRACTOR, AND THE UNITED STATES.

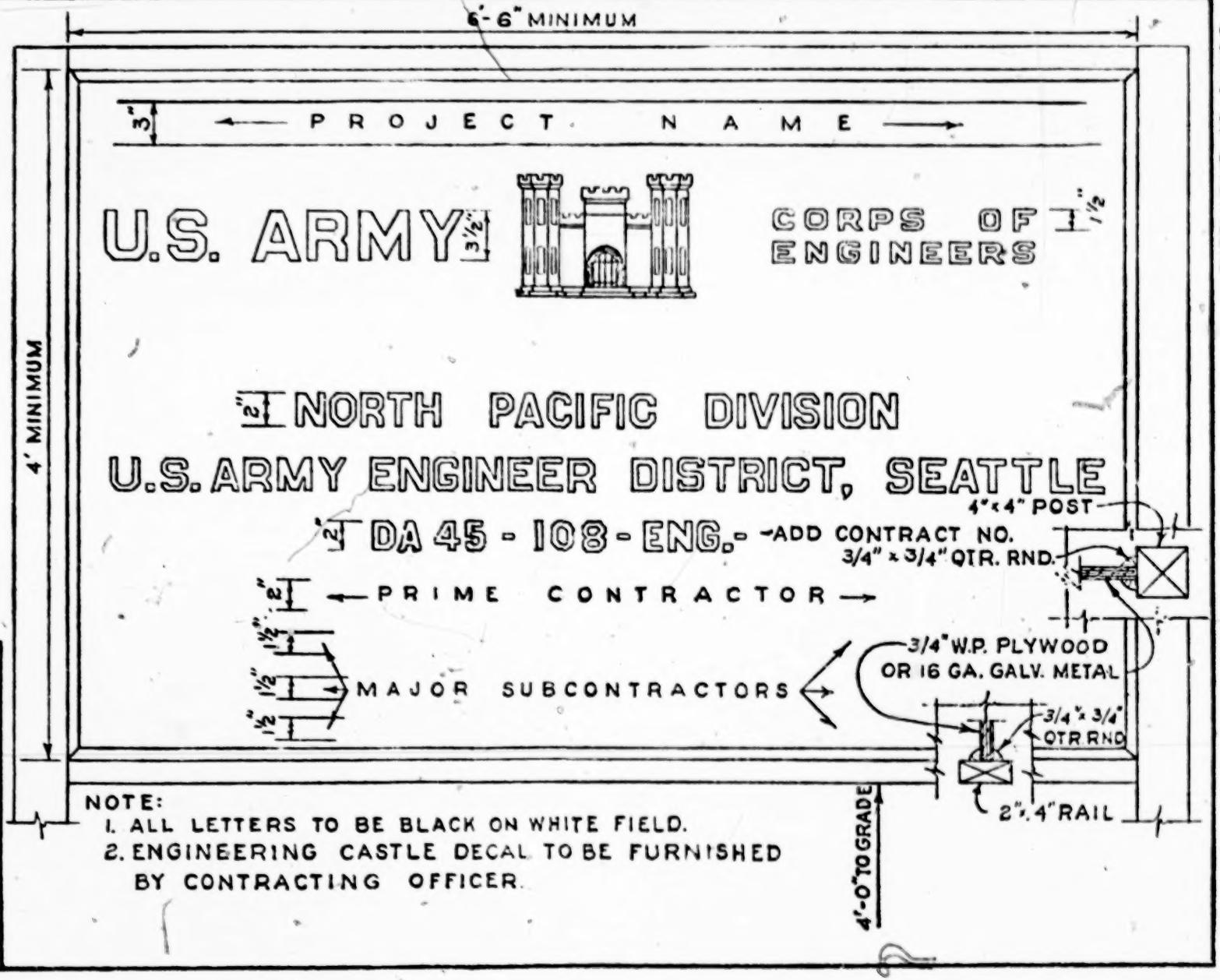
(17) The contract provides that the project is not subject to local real or personal property taxes. The United States agrees to hold the mortgagee harmless from payment of such taxes, and contends that such taxes are not applicable (Ex. 8, p. HC-8).

(18) Par. 3 of the "Lease" requires "that the lessee shall place each housing unit in the Project under the control of the Department as soon as it is available for occupancy as determined by the Commissioner."

NOTE: This is meaningless language, because:

a. The Capehart Act, 42 USCA 1594, requires that this identical clause be inserted in the contract between the United States and the Contractor:

> "The Secretary of Defense is authorized to enter into contracts with any eligible bidder to provide for the construction of urgently needed housing on lands owned * * * by the U.S. for the purpose of providing suitable living accommodations for military personnel * * * Any such contract shall provide that each housing unit in the project shall be placed under the control of the Secretary of



CORPS OF ENGINEERS

STANDARD DETAIL

PROJECT SIGN
U. S. ARMY

U.S. Army Eng. Dist., Seattle, Wn.
Dr. Not To Scale
Tr. J.F.B. 18 Sept. 1957
CK.

File No. 49-/40-0503

Defense as soon as the unit is available for occupancy * * * ."

b. The "Housing Contract" provides that the Contractor shall place each unit as completed "under the control of the Department" (Ex. 8, p. 7).

c. The figurehead never has any right of possession to turn over to the United States.

d. Art. XXI of the Housing Contract provides that every obligation purportedly placed upon the figurehead shall be performed instead by the contractor.

(19) Par. 5 of the lease provides:

"That the buildings and other improvements required to be furnished the project in accordance with the Drawings and Specifications SHALL BE AND BECOME REAL ESTATE AND PART OF THE LEASED PREMISES AND PROPERTY OF THE UNITED STATES."

NOTE: As each unit is completed, the contractor is required to place it under the sole control of the Army (Ex. 8, p. 7). The Lessee is prohibited from occupancy at any time during the lease (Ex. 8, p. 7). This clause goes further and says that the buildings as built become the property of the United States.

(20) The Federal Tort Claims Act applies to the project (Ex. 6, p. 9).

(21) The contractor is required to erect on the "leased" premises a large sign which tells the world that the project is that of the Army, and that the appellant is the contractor for the United States. A drawing of the required sign is contained in the Housing Contract (Ex. 8, p. HC-39) facing this page.

D. (2) FEDERAL QUESTION RAISED BELOW

By their Complaint (R. 3-4), their contentions in the Pre-trial order (R. 14), and the Findings of Fact and Conclusions of Law proposed by them (R. 64-67), appellants raised in the Superior Court the federal questions sought to be reviewed here, namely that levying a State sales tax on the construction of the military housing is prohibited by the supremacy clause of the Constitution of the United States.

On appeal to the Washington Supreme Court, appellants likewise raised the federal questions sought to be reviewed here in the assignment of error in their Opening Brief (R. 74) and in the arguments presented therein, and in their Reply Brief (R. 78).

The Supreme Court of Washington passed upon these Federal questions by holding that the Capehart corporation which the U.S. required be created was not its instrumentality, that the U.S. was not the buyer of the military housing, that assessing State sales tax against the Capehart corporation was not a tax by a State upon the U.S. or its instrumentality, and that the Washington State sales tax statutes required that the sales tax be assessed against the Capehart corporation (Appendix A). Quotations from the opinion are set forth in the following section.

E. THE FEDERAL QUESTION IS SUBSTANTIAL

The Federal question is substantial for the following reasons:

1. The State court held in effect that the United States or its instrumentality is subject to State sales

tax. Four members of the Washington State Supreme Court dissented on this basis, in the 5 to 4 decision below.

2. The State court decision is contrary to and substantially destroys the intent of Congress in substituting Capehart Act military housing (built by and for and financed by the U.S.) for the Wherry Act housing (under which land on a military reservation was truly leased to a private corporation which privately and at its own expense constructed the housing for its own use as rental property).

3. There is now a diversity of opinion by highest State courts on the identical question—the instant decision by the Washington State Supreme Court being directly contrary to the decision of the Supreme Court of Florida, *Green v. Eglin Air Force Base Housing, Inc.*, 104 So.(2d) 463, and directly contrary to the decision of the Supreme Court of Michigan, *Knapp-Stiles, Inc. v. Michigan Dept. of Revenue*, 370 Mich. 629, 122 N.W.(2d) 642. Florida and Michigan both hold that State sales tax cannot apply to Capehart housing contracts in that it would be a tax by a State upon the United States or its instrumentality (the figurehead corporation it required solely for its own financial ends).

In the *Green* case, the Florida Supreme Court held:

> "That Centex is a contractor employed by the United States is quite obvious. The United States advertised for bids for the work to be done. It accepted Centex's bid. It signed the contract with Centex and it is in process of supervising the construction. It arranged the method by which Centex will be paid and it is obligated to eventually pay

the cost of construction by paying off the mortgages. It would seem to be equally obvious that the materials purchased go into and become a part of the public works owned by the United States. * * *

"It is very doubtful if these corporations should be regarded as anything other than agencies or instrumentalities of the Federal Government. In *Clallam County, Wash. v. United States*, 263 U.S. 341, the Supreme Court held that a corporation created for the purpose of operating a sawmill and railroad in the promotion of the war effort during the first World War and which was wholly owned by the United States was an agency of the United States and that its property was, therefore, immune from State taxation. In describing the corporation there involved they used language peculiarly applicable to each AFB corporation:

"'The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends.'

"*The creation of the AFB corporations was only for the convenience of the United States to enable it to finance military construction in a manner determined by the Congress to be most conducive to the national interest.*" (Emphasis ours)

Similarly, in the *Knapp-Stiles* case, the Supreme Court of Michigan held with reference to identical Capehart housing:

"We agree with the holding of the trial court that plaintiff's housing construction contract is with the United States acting through its instrumentality, the Department (of the Army)."

To like effect, the four dissenting judges of the Su-

preme Court of the State of Washington in the instant case held:

> "Contemporaneous with the signing of the housing contract, the stock of the corporation in the instant case was irrevocably placed in escrow, together with the resignations of the officers and directors, to be delivered to the United States at the conclusion of the construction of the housing. There was no possible contingency for the return of the stock to the stockholders or the documents of resignation to the officers and directors. The corporation owned nothing of any value in the housing being constructed. It served solely as a means to the end of obtaining military housing for the United States. There was no possibility for it to engage in any purpose other than to serve the end of obtaining military housing for the United States on this exclusive project. Because it had no purposes independent of those of the United States, the corporation was nothing more than an instrumentality thereof. * * * it was nothing more than an instrumentality of the United States Government; that it had no commercial purpose other than the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the Federal Government applies."

The majority opinion in the instant case, on the other hand, without pointing to one single fact to support its statement, holds:

> "The mortgagor-builder corporate entity created for the purpose of constructing and financing Capehart housing serves a separate and distinct function from that of the United States."

This diversity of opinion in State Court rulings should be resolved by this Court.

4. Of great substantial importance, is the fact that in the Capehart Act, Congress has conceived a new and useful method of financing Federal projects. It does so by the use of private banking or institutional capital which the United States directs be borrowed with the aid of its instrumentality, the creation of which is commanded by the United States. The loan executed by this instrumentality of the United States is to be repaid to the lender directly by the United States, and not by its instrumentality.

Congress may well determine to use this method of Federal financing, and other methods akin thereto, for future military projects and for future Federal non-military projects.

The instant 5 to 4 decision of the Supreme Court of the State of Washington, if allowed to stand — that when the United States determines to finance its public projects in this manner, the entity which the United States requires be created solely for its own financial ends is not an instrumentality of the United States and is subject to State taxation — can well substantially impair or destroy the desirable flexibility of method available to Congress in financing necessary Federal projects.

5. In addition, we adopt in full the reasons set forth in the corresponding portions of their Jurisdictional Statement by the two other companion cases with which we were consolidated for trial and which are simultaneously on appeal to this Court. In the interests of

brevity we are adopting their reasons by reference, instead of repeating the same herein.

CONCLUSION

The question presented is so substantial as to require plenary consideration, with briefs on the merits and oral argument, for their resolution.

Respectfully submitted,

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APPENDICES
A AND B

Appendix A—Opinion of the Supreme Court of the State of Washington App. A, pages 3 to 24

Appendix B—Statutes Involved App. B, pages 1 to 13

APPENDIX A

OPINION OF THE SUPREME COURT OF THE STATE OF WASHINGTON

[Nos. 36226, 36227, 36228, 36229. En Banc. August 1, 1963]

IAN MURRAY *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *Appellant*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.*

Consolidated appeals from judgments of the Superior Court for Thurston County, Nos. 32176, 32186, 32195, 32196, Charles T. Wright, J., entered July 3, 1961. *Affirmed.*

Consolidated actions to recover taxes paid under protest. Plaintiffs appeal from judgments in favor of the defendant.

Bogle, Bogle & Gates, Edward G. Dobrin, and *Richard S. Sprague*, for appellants Murray *et al.*

Allen, DeGarmo & Leedy and *Seth W. Morrison*, for appellants Inland Empire Builders, Inc., *et al.*

Casey & Pruzan, by *Carl Pruzan*, for appellants Hebb & Narodick Construction Co., Inc., *et al.*

The Attorney General, John W. Riley, Chief Assistant, and *Timothy R. Malone, Assistant*, for respondents.

OTT, C, J.—This appeal is a consolidation of four actions brought by several contractors to recover a retail sales tax paid under protest, and to enjoin the State Tax Commission from assessing the sales tax in connection with the construction of Capehart Act housing at military installations in Washington.

From adverse judgments, the contractors appeal.

The facts upon which these appeals are predicated are not in dispute. The legal issue involved is whether the transactions, pursuant to which the military housing was constructed, are shielded from state taxation by the sovereign immunity granted to the United States government by the federal and state constitutions.

Each of the appellants was awarded contracts under the provisions of the Capehart Act (69 Stat. 651-654 as amended). Since the contract provisions are identical, we will refer only to the material portions of the documents in cause No. 36226. The procedure for the execution of a contract under the act, in so far as here material, may be stated as follows:

The Secretary of Defense, after determining a need for military housing, issues an invitation for bids. The contractor submitting the lowest acceptable bid receives a "Letter of Acceptability" from the Secretary. The letter requires the successful bidder to establish a private "mortgagor-builder" corporation under the laws of the state of Delaware, and to qualify it to do business in the state involved. The contractor furnishes the corporation with $1,000 for capital stock, purchases all of it, and elects its officers and directors. The United States government executes to the corporation a 55-

year lease of the real estate upon which the housing is to be constructed. The corporation is to obtain private financing by giving a mortgage on its leasehold, and obtain a commitment from the Federal Housing Administration to insure its mortgage loan. The mortgage loan in is the amount of the contractor's bid.

The "Letter of Acceptability" prescribes the "initial closing" procedure, which entails the execution of the following documents:

(1) The 55-year lease between the United States and the corporation for a consideration of $1,000, paid by the corporation to the United States government. The corporation agrees, during the period of construction, to maintain insurance and to save the United States government harmless from many laws, ordinances, and regulations applicable to the leased premises, with regard to construction, sanitation, licenses or permits to do business.

(2) The corporation executes a note, secured by a real and chattel mortgage on its real-estate leasehold, to the private lender.

(3) The corporation, contractor, and the United States execute a housing contract which provides that all construction is to be inspected and supervised by the United States; that progress payments are to be made by the corporation from the mortgage loan, upon request of the contractor and approval of the United States, and that, upon full payment, title to the housing units vests in the United States, subject to contractor liability for latent defects. The contract further provides that the contractor shall act as agent for the cor-

poration, guarantee its performance, and furnish a performance bond to the corporation and the mortgagee.

(4) An irrevocable escrow agreement is executed which provides that the resignations of the officers and directors of the corporation, and the stock certificates of the corporation, endorsed in blank, are to be placed in escrow, with instructions to the escrow holder to deliver these documents to the United States upon completion and acceptance of the project.

(5) The United States executes a written guarantee to pay the mortgage installment payments to the private mortgagee and/or the Federal Housing Administration, the insurer.

The provisions of the Capehart Act were fully complied with by the contractors involved in these appeals.

Appellants' assignments of error raise two principal issues: First, the appellant contractors contend that, under Washington law, the consumer of the housing project is the party liable for payment of the sales tax, and that, as a result of the statutory method for the construction of Capehart housing, the United States is the consumer and, therefore, its constitutional immunity from state taxation applies. Secondly, appellants contend that the mortgagor-builder corporation is an agency of the United States and, as such, is immune from state tax.

[1] The function of interpreting state statutes to determine who is liable for payment of a sales tax is reserved to the state courts involved. *Alabama v. King & Boozer*, 314 U.S. 1, 86 L.Ed. 3, 62 S.Ct. 43, 140 A.L.R.

615 (1941); *Kern-Limerick, Inc., v. Scurlock*, 347 U.S. 110, 98 L.Ed. 546, 74 S.Ct. 403 (1954).

RCW 82.08.020 provides that " . . . there shall be collected a tax on each retail sale in this state . . . " A retail sale is defined in RCW 82.04.050 as including

" . . . the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following: . . . (b) the constructing . . . of new or existing buildings or other structures under, upon, or above real property *of or for consumers*, . . . " (Italics ours.)

A consumer is defined in RCW 82.04.190(4) as "Any person who is an *owner, lessee or has the right of possession* to or an easement in real or personal property . . . " (Italics ours.)

RCW 82.08.050 provides in part:

"The tax hereby imposed shall be paid by the *buyer* to the seller, and each *seller* shall collect from the *buyer* the full amount of the tax payable in respect to each taxable sale . . .

"In case any seller fails to collect the tax herein imposed . . . he shall . . . be personally liable to the state for the amount of the tax." (Italics ours.)

Appellants concede that a retail sale, as defined in RCW 82.04.050, did occur, but contend that the consumer defined in RCW 82.04.190, and the buyer denominated in RCW 82.08.050 are synonymous, and that the United States government is the consumer and taxable party because it becomes the owner of the housing units upon their completion and acceptance.

[2] With this contention, we do not agree. One of the purposes of RCW 82.04.050 is to define the event that gives rise to a taxable transaction, which is the rendition of labor and services in the construction of new buildings upon real property of or for consumers. RCW 82.04.190 establishes the means by which the consumer is identified. These sections do not designate the party liable for payment of the tax in any given transaction. RCW 82.08.050 provides that the retail sales tax shall be borne by the buyer, who is primarily liable for payment of the tax. *Kaeser v. Everett*, 47 Wn.(2d) 666, 289 P.(2d) 343 (1955).

We must therefore determine who is the buyer under the facts of the instant case. In this regard, appellants contend that the United States is the buyer because it bears the economic burden of paying for the military housing, by virtue of its guarantee of the mortgage obligation.

In *Alabama v. King & Boozer, supra*, the state of Alabama, pursuant to a statute which imposed the sales tax upon the purchaser, levied a sales tax upon the sale of lumber to a contractor who was constructing installations for the Army. It was there contended that the sales tax could not be collected from the contractor for the reason that the United States was the purchaser, within the meaning of the Alabama statute. In answering this contention, the Supreme Court of the United States held:

" . . . The taxing statute, as the Alabama courts have held, makes the 'purchaser' liable for the tax to the seller, who is required 'to add to the sales price' the

amount of the tax and collect it when the sales price is collected, whether the sale is for cash or on credit. Who, in any particular transaction like the present, is a 'purchaser' within the meaning of the statute, is a question of state law on which only the Supreme Court of Alabama can speak with final authority. *But it seems plain, as the Government concedes and as we assume for present purposes, that under the provisions of the statute the purchaser of tangible goods who is subjected to the tax measured by the sales price, is the person who orders and pays for them when the sale is for cash or who is legally obligated to pay for them if the sale is on credit....*" (Italics ours.)

The court concluded:

"We cannot say that the contractors were not, or that the Government was, bound to pay the purchase price, or that the contractors were not the purchasers on whom the statute lays the tax. The added circumstance that they were bound by their contract to furnish the purchased material to the Government and entitled to be reimbursed by it for the cost, including the tax, no more results in an infringement of the Government immunity than did the tax laid upon the contractor's gross receipts from the Government in *James v. Dravo Contracting Co., supra* [302 U.S. 134]."

[3, 4] Applying this rule, the buyer is the person who is *legally obligated* to pay the seller in any transaction. The housing contract executed by the parties provided that "The mortgagor-builder [corporation] shall pay the eligible-builder [contractor] for the performance of this Housing Contract, and all other obligations of

the eligible builder herein, . . . " By the express terms of the contract, the corporation, and not the United States, was obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. Under the provisions of the Capehart Act and the facts in the instant case, the United States government was not obligated to pay the seller. The fact that the ultimate economic burden of the tax may fall upon the United States does not vitiate a state tax on the transactions. *Alabama v. King & Boozer, supra; Kern-Limerick, Inc., v. Scurlock, supra; United States v. Detroit,* 355 U.S. 466, 2 L.Ed.(2d) 424, 78 S.Ct. 474 (1958); *E. I. Du Pont de Nemours & Co. v. State,* 44 Wn.(2d) 339, 267 P.(2d) 667 (1954).

Our conclusion in this regard is also supported by the following cases:

United States v. Harrison & Grimshaw Constr. Co., 305 F.(2d) 363 (1962), involved the question of whether the provisions of the Miller Act applied to the performance bond given by the eligible builder under a Capehart Act contract. The court held (p. 368):

" . . . The projects are of a private nature until completition and assumption of control by the government. *The mortgagor-builder has a contract with a construction company to build the project. The constructor looks to the mortgagor-builder for payment for his work and owes to the mortgagor-builder the obligation to perform. . . .* " (Italics ours.)

In *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York,* 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), it was said:

"Likewise, we must reject appellant's contention that the subject mortgages, as direct obligations to the United States, are immune from State or local taxation, as provided in section 3701 of the Revised Statutes of the United States (U. S. Code, tit. 31, § 742) which exempts 'Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States' since they are not 'of the same type as those specifically enumerated' in the statute (*Smith v. Davis*, 323 U.S. 111, 117). Under the arrangement authorized by the Enabling Act, it is clear that the device employed was designed to relieve the Government of its financially burdensome obligation to provide housing for its military personnel and at the same time avoid increasing the national debt. It did not pledge its credit in the usual sense, but merely guaranteed each 'periodic payment' based on a monthly average of $90 per family unit."

Congress, in its discretion, by enacting the Capehart law, chose to leave the hazards of construction, the purchasing of proper materials, and the furnishing of proper labor performance to private contractors and private lenders. It chose to guarantee only the payment to the private lender, after units acceptable to the government were erected upon the leased premises. We conclude, therefore, that the mortgagor-builder corporation was the party legally obligated to pay the contractor, and that it was the buyer denominated in RCW 82.08.050.

Is the mortgagor-builder corporation an agency of the United States?

Appellants contend that title to the units, when built in accordance with the contracts, vested in the United States; that the United States controlled and dictated the terms of the construction contracts, and that it guaranteed the mortgage obligation and ultimately gained ownership of all of the corporation's capital stock; hence, the corporation is a government agency.

In support of this contention, appellants rely on *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923); *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958); and *Knapp-Stiles, Inc., v. Michigan Department of Revenue*, CCH 2 Mich. Tax Cases ¶ 200-202 (1962).

The *Clallam County* case held that a corporation, organized pursuant to a World War I emergency act which authorized the Director of Aircraft Production to establish one or more state corporations to produce war materials, was an agency of the United States and, as such, its activities were exempt from state taxation. The case is not apropos. The Director of Aircraft Production was, by law, an agent of the government. In the instant case, the successful bidders were not authorized agents of the government. Furthermore, the facts in the cited case did not disclose any evidence of an intent to distinguish the corporate activities from those of the United States. In this regard, the court stated (p. 345): " . . . This is not like the case of a corporation having its own purposes as well as those of the United States . . . "

In the *Green* case, the court stated (p. 467):

" . . . The question here is the extent of an *exemp-*

tion granted by *state statute*. Had the legislature intended to limit the exemption to that required by the Federal Constitution there would have been no occasion whatever to go further than to say "There shall also be exempted all sales made to the United States." But the legislature intended to grant a greater exemption and made that intent clear . . . ' "

In *Knapp-Stiles, Inc., v. Michigan Department of Revenue, supra,* the court stated:

"At the outset, it may be noted that the question is *not* whether the State has the *power* to impose such tax upon contractors who are performing contracts with the United States.

" . . .

"Michigan has the power to impose such a tax. Has it done so? Or has it, by the language of the statute, exempted the sales here involved from the tax? . . . "

In the *Green* and *Knapp-Stiles* cases, the result was determined by interpreting a state exemption statute much broader than our own, for which reason the cases are distinguishable.

[5] The mortgagor-builder corporate entity created for the purpose of constructing and financing Capehart housing serves a separate and distinct function from that of the United States. That such a corporation is not an agency of the United States is sustained by the following decisions:

In *In re S. S. Silberblatt, Inc., v. Tax Commission of the State of New York, supra,* the New York Court of Appeals held that the mortgagor-builder corporation

was subject to that state's mortgage recording tax, stating (p. 641):

"The appellant's contention that this petitioner and the five corporate mortgagors are instrumentalities of the Federal Government or its agencies and, as such, are exempt from State and local taxation, is without substance.... At the time of the execution, delivery and recording of these mortgages, each of the mortgagors was a private corporation, all of the capital stock of which was privately owned. They were created for a commercial purpose for private profit, as distinguished from a governmental purpose. In the absence of statute to the contrary, it may not be assumed that a governmental function was involved. They possess all of the requisites and responsibilities of corporate existence and, as such, *are an entity separate and apart from the United States* (*United States v. Strang*, 254 U.S. 491) *and this is so, notwithstanding the fact that all of the capital stock of each corporation will ultimately be owned by the Federal Government* (*Sloan Shipyards v. United States Fleet Corp.*, 258 U.S. 549, 42 S.Ct. 386, 66 L.Ed. 762) ..." (Italics ours)

In *United States v. Ft. George G. Meade Defense Housing Corp. No. 1*, D.C., 186 F.Supp. 639 (1960), it was held that the leasehold interest acquired by the mortgagor-builder corporation from the United States was subject to the Maryland mechanics' lien law because

"... the so-called Capehart Act contemplates leaving the entire arrangement for the financing and construction of Capehart housing projects in the hands of

private enterprise until the point at which the government has secured the capital stock of the Housing Corporation . . . "

The reasoning in the following cases, although not arising from Capehart transactions, supports the view that the mortgagor-builder corporations are not agencies of the government.

In *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn. (2d) 339, 267 P.(2d) 667 (1954), it was contended that the Du Pont Company was an agent or instrumentality of the United States in its operation of the Hanford Engineer Works. We held (pp. 349, 350):

" . . . the fact that the government reserved and exercised the right to restrict or control the action of the contractor as to its general activities does not establish the existence of an agency relationship. . . .

" . . .

"It is also without significance that all of the real and personal property utilized in performing the contract was owned by the government. [Citing cases.] The same is true with regard to the fact that the government exerted unusual supervisory controls over every phase of the contractor's activity. [Citing case.]"

In *United States v. Brown*, D.C., 41 F.Supp. 838 (1941), the contention was rejected that certain Regional Agricultural Credit Corporations, created pursuant to federal enactment, were immune from state taxation because the United States owned all of the capital stock of the corporations. The court said (p. 840):

"Whether or not these Regional Corporations shall enjoy sovereign immunity from taxation is wholly a

question of Congressional intent. They are purely commercial corporations exercising no sovereign function. In the absence of statutory provision, there is no reason why they should be exempted from taxation, especially in view of Congressional policy concerning this type of corporation, evidenced by many statutory provisions expressly subjecting the real property of similar corporations to taxation.

"The mere fact that the United States owns all the capital stock of these corporations is not alone sufficient to endow them with sovereign immunity, nor do they acquire such immunity merely because they are the medium through which the Government carries out certain proprietary activities. Note, 83 L.Ed. 799 et seq.

" . . .

"When a corporation is created for commercial as distinguished from Governmental purposes, it is ordinarily implied in the absence of statutory provisions to the contrary, that such corporation shall have all the requisites and responsibilities of corporate existence, even though the United States owns all the stock. Such a corporation is an entity separate from the United States. *United States v. Strang*, 254 U.S. 491, 41 S.Ct. 165, 65 L.Ed. 368."

We conclude that the mortgagor-builder corporation, having served an independent and distinct purpose in the taxable event, is not a federal agency.

Further, Congress has not expressed a legislative intent to immunize a Capehart corporation from state taxation. The invitations to bid expressly provided:

"Nothing in this Invitation for Bids shall be deemed

to relieve the eligible builder of any liability for the payment of sales or use taxes properly levied."

For the reasons stated, the sales tax was "properly levied" upon these transactions. Appellants, under the statute, were obligated to collect the tax from the mortgagor-builder corporations. Having failed to collect it, appellants are liable for the tax. RCW 82.08.050, *supra*.

The judgments are affirmed.

FINLEY, ROSELLINI, HAMILTON, and HALE, JJ., concur.

HUNTER, J. (dissenting)—The majority say that the sales tax must fall upon the person legally obligated to pay for construction of the military housing. With this I agree.

The majority then state that, by the express terms of the contract with the mortgagor-builder, the Delaware corporation, and not the United States was legally obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. The fact that the ultimate economic burden of the tax may fall upon the United States does not constitute it as the person legally obligated to pay the tax. Neither do I disagree with this rationale.

It is my disagreement with the majority in the disposition of the issue relating to whether the mortgagor-builder corporation is an instrumentality of the United States that bring me to a result contrary to that of the majority in this case.

Under the established rule for the construction of contracts, a contract must be picked up by its four

corners and considered in its entirety. In so doing, it is inescapable to conclude other than that the prime purpose of the housing contract was the construction of military housing for the exclusive use of the United States. It was necessarily the obligation of the government to pay for this housing and, although it did not wish to be directly obligated, the United States, in causing the Delaware corporation to be organized, did so to provide a means to carry out its obligation to compensate the contractors for the construction of this housing.

In *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923), it was held that a corporation created for the purpose of operating a sawmill and railroad for the promotion of the war effort and wholly owned by the United States was an instrumentality of the United States. The court there said:

"In short the Spruce Production Corporation was organized by the United States an an instrumentality for carrying on the war, all its property was conveyed to it by or bought with money coming from the United States and *was used by it solely as means to that end*, and when the war was over it stopped its work except so far as it found it necessary to go on in order to wind up its affairs. . . .

" . . .

"The State claims the right to tax on the ground that taxation of the agency may be taxation of the means employed by the government and invalid upon admitted grounds, but that taxation of the property of the agent is not taxation of the means. We agree that it

'is not always, or generally, taxation of the means,' as said by Chief Justice Chase in *Thomson v. Pacific Railroad*, 9 Wall 579, 591. But it may be, and in our opinion clearly is when as here not only the agent was created but all the agent's property was acquired and used, for the sole purpose of producing a weapon for the war. *This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account. The incorporation and formal erection of a new personality was only for the convenience of the United States to carry out its ends. . . .* " (Italics mine.)

Contemporaneous with the signing of the housing contract, the stock of the corporation in the instant case was irrevocably placed in escrow, together with the resignation of the officers and directors, to be delivered to the United States at the conclusion of the construction of the housing. There was no possible contingency for the return of the stock to the stockholders or the documents of resignation to the officers and directors. The corporation owned nothing of any value in the housing being constructed. It served solely as a means to the end of obtaining military housing for the United States. There was no possibility for it to engage in any purpose other than to serve the end of obtaining military housing for the United States on this exclusive project. Because it had no purposes independent of those of the United States, the corporation was nothing more than an instrumentality thereof.

The appellants cite *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958), which is persuasive

of their contention. There, under the authority of the Capehart Act, the government entered into a contract virtually identical with that of the instant case for the construction of military housing at the Eglin Air Force Base in Florida. The Florida court in effect found that the Delaware corporations were government instrumentalities, stating:

"'The AFB corporations were created at the direction of the United States for the sole purpose of borrowing money to be expended in constructing facilities needed by the United States, to be repaid by the United States and further securing the payment of this money by a mortgage upon property of the United States. These corporations will continue in existence until the mortgage debts are paid, so as to provide a party against whom the mortgages may be foreclosed in the remote contingency that the United States defaults in its obligation to pay the mortgage debt.

"'Even if we regard the AFB corporation as private enterprises, their interest in the property is so neglible —lessees without right of use or possession—as to make it entirely unrealistic to hold that it destroys the status of these buildings as a part of the public works of the United States.

"'It is very doubtful if these corporations should be regarded as anything other than agencies or instrumentalities of the Federal Government. In *Clallam County, Wash. v. United States*, 263 U.S. 341, 44 S.Ct. 121, 68 L.Ed. 328, the Supreme Court held that a corporation created for the purpose of operating a sawmill and railroad in the promotion of the war ef-

fort during the first World War and which was wholly owned by the United States was an agency of the United States and that its property was, therefore, immune from state taxation. In describing the corporation there involved the [sic] used language peculiarly applicable to each AFB corporation: "The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends." The creation of the AFB corporations was only for the convenience of the United States to enable it to finance military construction in a manner determined by the Congress to be most conducive to the national interest. . . . ' "

The limited function of the Delaware corporation, its power and purpose are aptly stated by the Michigan court in *Knapp-Stiles, Inc., v. Michigan Department of Revenue*, CCH 2 Mich. Tax Cases ¶ 200-202 (1962). There, as here, the contracts were for military housing under the Capehart Act. The court said relative to the corporations:

" . . . In the Invitation for Bids, which is prepared and issued by the United States, acting through the Department of the Air Force, there is found in Paragraph 1, above quoted, the following:

" 'The statute further contemplates that the Government-owned housing site be leased to a mortgagor or borrower corporation *which will act as a channel* for the proceeds of the mortgage loan from the lender to the successful bidder . . . '

"And a review of the documents—the lease, the contract, and the mortgage is convincing that this is sub-

tantially the only function that the Delaware corporation do perform.

"They have no real powers except to do the bidding of the United States. . . .

" . . .

"The corporations do not determine the terms of the contract. That is all done before the corporations come into existence. They do not determine whether the contract has been performed. They cannot modify its terms. They cannot terminate it.

"True, the corporations had a lease upon the premises. While this is nominally for a fifty-five year term, in fact, the actual possession, maintenance and operation of the housing is in the hands of the United States and its Air Force as soon as the housing is ready for occupancy.

"The United States alone determines the terms of the contract. It alone can modify or terminate it. It alone determines when it has been performed."

An analysis of *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), cited by the majority, discloses that the opinion is based on the erroneous premise that the Delaware corporations were " . . . created for a commercial purpose for private profit, as distinguished from a governmental purpose." As heretofore stated, consideration of the housing contract in its entirety cannot support such a conclusion. The analysis of the housing contract and the reasoning of the dissent in the *Silberblatt* case is correct.

"... Although under our State law the tax is imposed upon the recording of the mortgage (*Franklin Soc. v. Bennett*, 282 N.Y. 79), this case is controlled by Federal law under which the tax is on the mortgage itself, which is a Federal instrumentality exempt from State taxation (*Federal Land Bank v. Crosland*, 261 U.S. 374; ...). Unlike the Wherry Act, the Capehart Act, under which this military housing project was authorized, renders petitioner-appellant merely a builder and not a private sponsor of the military housing. The United States, through its Department of Defense, is the sponsor, financier and owner of the entire project. The mortgagor corporations are mere fictions, and they and the mortgagee banks had no other function in this business than to act as agents for the Federal Government (*Clallam County v. United States*, 263 U.S. 341, 345, 44 S.Ct. 121, 68 L.Ed. 328; *Railroad Co. v. Peniston*, 18 Wall 5, 42, 85 U.S. 5, 42, 21 L.Ed. 787) ..."

The majority attempt to distinguish the *Clallam County* case on the basis that the corporation there had no purpose other than to produce war materials for the United States government, and it quotes from the *Clallam County* case as follows:

"'... This is not like the case of a corporation having its own purposes as well as those of the United States....'"

The inference from this quotation which is desired by the majority is that the Delaware corporation had purposes other than those of the United States government. This is erroneous and unsupported by the record.

The holding of the cases cited by the majority, *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn.(2d) 339, 267 P.(2d) 667 (1954), and *United States v. Brown*, 41 F.Supp. 838 (1941), is not inconsistent with the *Clallam County* case since the corporations, in those cases, were not instrumentalities of the United States because they had separate commercial purposes for private profit.

In the instant case we should hold that, although the mortgagor-builder is the "buyer" to whom the retail sale of the housing project construction was made, it was nothing more than an instrumentality of the United States government; that it had no commercial purpose other than for the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the federal government applies.

The judgment of the trial court should be reversed, and the cause remanded with instructions to enter judgment restraining the Tax Commission from imposing the tax and to permit recovery of the tax which appellants paid under protest.

HILL, DONWORTH, and WEAVER, JJ., concur with HUNTER, J.

APPENDIX B

STATUTES INVOLVED

Revised Code of Washington

RCW 82.08.010 Definitions. For the purposes of this chapter:

(1) "Selling price" means the consideration, whether money, credits, rights, or other property, expressed in the terms of money paid or delivered by a buyer to a seller, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer;

(2) "Seller" means every person making sales at retail or retail sales to a buyer or consumer, whether as agent, broker, or principal;

(3) "Buyer" and "consumer" include, without limiting the scope hereof, every individual, receiver, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise, municipal corporation, quasi municipal corporation, and also the state, its departments and institutions and all political subdivisions thereof, irrespective of the nature of the activities engaged in or

functions performed, and also the United States or any instrumentality thereof;

(4) The meaning attributed in chapter 82.04 to the terms "tax year," "taxable year," "person," "company," "sale," "sale at retail," "retail sale," "sale at wholesale," "wholesale sale," "business," "engaging in business," "cash discount," "successor," "consumer," "in this state" and "within this state" shall apply equally to the provisions of this chapter. . . .

RCW 82.08.020 Retail sales tax imposed. There is levied and there shall be collected a tax on each retail sale in this state equal to three and one-third per cent of the selling price: *Provided*, That from April 1, 1959 the tax imposed by this section shall be equal to four per cent of the selling price. The tax imposed under this chapter shall apply to successive retail sales of the same property and to the retail sale of intoxicating liquor by the Washington state liquor stores. . . .

RCW 82.08.030 Exemptions. The tax hereby levied shall not apply to the following sales:

(1) Casual and isolated sales of property or service, unless made by a person who is engaged in a business activity taxable under chapters 82.04., 82.16 or 82.28: *Provided*, That the exemption provided by this paragraph shall not be construed as providing any exemptio nfrom the tax imposed by chapter 82.12;

(2) Sales made by persons in the course of business activities with respect to which tax liability is specifically imposed under chapter 82.16, when the gross proceeds from such sales must be included in the measure of the tax imposed under said chapter;

(3) The distribution and newsstand sales of newspapers;

(4) Sales which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(5) Sales of motor vehicle fuel used in aircraft by the manufacturer thereof for research, development, and testing purposes and sales of motor vehicle fuel taxable under chapter 82.36: *Provided*, That the use of any such fuel upon which a refund of the motor vehicle fuel tax has been obtained shall be subject to the tax imposed by chapter 82.12;

(6) Sales (including transfers of title through decree of appropriation) heretofer or hereafter made of the entire operating property of a publicly or privately owned public utility, or of a complete operating integral section thereof, to the state or a political subdivision thereof for use in conducting any business defined in subdivisions (1), (2), (3), (4), (5), (6), (7), (8), (9), (10) or (11) of RCW 82.16.010;

(7) Auction sales made by or through auctioneers of tangible personal property (including household goods) which have been used in conducting a farm activity, when the seller thereof is a farmer and the sale is held or conducted upon a farm and not otherwise;

(8) Sales to corporations which have been incorporated under any act of the congress of the United States and whose principal purposes are to furnish volunteer aid to members of armed forces of the United States and also to carry on a system of national and international relief and to apply the same in mitigat-

ing the sufferings caused by pestilence, famine, fire, floods, and other national calamities and to devise and carry on measures for preventing the same;

(9) Sales of purebred livestock for breeding purposes where the animals are registered in a nationally recognized breed association; sales of cattle and milk cows used on the farm;

(10) Sales of tangible personal property (other than the type referred to in subdivision (11) hereof) for use by the purchaser in connection with the business of operating as a private or common carrier by air, rail, or water in interstate or foreign commerce: *Provided*, That any actual use of such property in this state shall, at the time of such actual use, be subject to the tax imposed by chapter 82.12;

(11) Sales of airplanes, locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state; also sales of tangible personal property which becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers used by the holder of a carrier permit issued by the Interstate Commerce Commission authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; also sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving;

(12) Sales of motor vehicles and trailers to be used for the purpose of transporting therein persons or property for hire in interstate or foreign commerce: *Provided*, That the purchaser must be the holder of a carrier permit issued by the Interstate Commerce Commission and that the vehicles will first move upon the highways of this state from the point of delivery in this state to a point outside of this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100;

(13) Sales of motor vehicles and trailers to nonresidents of this state for use outside of this state, even though delivery be made within this state, but only when (a) the vehicles or trailers will be taken from the point of delivery in this state directly to a point outside this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100, or (b) said motor vehicles and trailers will be registered and licensed immediately under the laws of the state of the purchaser's residence, will not be used in this state more than three months, and will not be required to be registered and licensed under the laws of this state.

(14) Sales to nonresidents of this state for use outside of this state of tangible personal property which becomes a component part of any machinery or other article of personal property belonging to such nonresident, in the course of installing, repairing, cleaning, altering, or improving the same and also sales of or charges made for labor and services rendered in respect to any installing, repairing, cleaning, altering, or

improving, of personal property of or for a nonresident, but this subsection (14) shall apply only when the seller agrees to, and does, deliver the property to the purchaser at a point outside this state, or delivers the property to a common or bona fide private carrier consigned to the purchaser at a point outside this state;

(15) Sales to nonresidents of this state for use outside of this state of watercraft requiring coast guard registration or registration by the state of principal use according to the Federal Boating Act of 1958, even though delivery be made within this state, but only when (a) the watercraft will not be used within this state for more than forty-five days and (b) an appropriate exemption certificate supported by identification ascertaining residence as provided by the tax commission and signed by the purchaser or his agent establishing the fact that the purchaser is a non-resident and that the watercraft is for use outside of this state, one copy to be filed with the tax commission with the regular report and a duplicate to be retained by the dealer.

(16) Sales of baby chicks and turkey poults for use in the production for sale of poultry or poultry products.

(17) Sales to nonresidents of this state for use outside of this state of machinery and implements for use in conducting a farming activity, when such machinery and implements will be transported immediately outside the state. As proof of exemption, an affidavit or certification in such form as the tax commission shall require shall be made for each such sale, to be retained as a business record of the seller.

(18) Sales for use in noncontiguous states, territories and possessions of the United States, but only when, as a necessary incident to the contract of sale, the seller delivers the subject matter of the sale to the purchaser or his designated agent at the usual receiving terminal of the carrier selected to transport the goods, under such circumstances that it is reasonably certain that the goods will be transported directly to a destination in such noncontiguous states, territories and possessions. . . .

* * *

RCW 82.08.050 Buyer to pay, seller to collect tax—Penalties. The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections adopted by the tax commission pursuant to the provisions of RCW 82.08.060. The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the commission, and any seller who appropriates or converts the tax collected to his own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter shall be guilty of a misdemeanor.

In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the commission in the manner prescribed by this chapter, whether such failure is the result of his own acts or the result of acts or conditions beyond his control, he

shall, nevertheless, be personally liable to the state for the amount of the tax.

The amount of tax, until paid by the buyer to the seller, or to the commission, shall constitute a debt from the buyer to the seller and any seller who fails or refuses to collect the tax as required with intent to violate the provisions of this chapter or to gain some advantage or benefit, either direct or indirect, and any buyer who refuses to pay any tax due under this chapter shall be guilty of a misdemeanor.

Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the commission, the commission may, in its discretion, proceed directly against the buyer for collection of the tax, in which case a penalty of ten percent may be added to the amount of the tax for failure of the buyer to pay the same to the seller, regardless of when the tax may be collected by the commission; and all of the provisions of chapter 82.32, including those relative to interest and penalties, shall apply in addition; and, for the sole purpose of applying the various provisions of chapter 82.32, the fifteenth day of the month following the bimonthly tax period in which the purchase was made shall be considered as the due date of the tax. . . .

RCW 82.08.060 Collection of tax — Methods and schedules. The tax commission shall have power to adopt rules and regulations prescribing methods and schedules for the collection of the tax required to be collected by the seller from the buyer under this chapter. The methods and schedules prescribed shall be

adopted so as to eliminate the collection of fractions of one cent and so as to provide that the aggregate collections of all taxes by the seller shall, insofar as practicable, equal the amount of tax imposed by this chapter. Such schedules may provide that no tax need by collected from the buyer upon sales below a stated sum and may be amended from time to time to accomplish the purposes set forth herein. . . .

* * *

RCW 82.08.140 Administration. The provisions of RCW 82.04.470 and all of the provisions of chapter 82.32 shall have full force and application with respect to taxes imposed under the provisions of this chapter. . . .

"SALE DEFINED

RCW 82.04.040 "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consid ation and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. It also includes the furnishing of food, drink, or meals for compensation whether consumed upon the premises or not.

"Casual or isolated sale" means a sale made by a person who is not engaged in the business of selling the type of property involved.

"SALE AT RETAIL," "RETAIL SALE" DEFINED

RCW 82.04.050 "Sale at retail" or "retail sale" means every sale of tangible personal property (including articles produced, fabricated, or imprinted) other than a sale to one who (a) purchases for the purpose of resale as tangible personal property in the regular course of business, or (8) installs, repairs, cleans, alters, imprints, improves, constructs, or decorates real or personal property of or for consumers, if such tangible personal property becomes an ingredient or component of such real or personal property, or (c) purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. The term also means every sale of tangible personal property to persons engaged in any business which is taxable under RCW 82.04.280, subsection (2), and 82.04.290.

The term "sale at retail" or "retail sale" shall include the sale or charge made for tangible personal property consumed and or for labor and services rendered in respect to the following: (a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers, excluding, however, services rendered in respect to live animals, birds and insects; (b) the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above

real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include the sale of services or charges made for the clearing of land and the moving of earth, excepting the mere leveling of land used in commercial farming or agriculture; (c) the sale of or charge made for labor and services rendered in respect to the cleaning, fumigating, razing or moving of existing buildings or structures, but shall not include the charge made for janitorial services; (d) the sale of or charge made for labor and services rendered in respect to automobile towing, armored car service and similar automotive transportation services, but not in respect to those required to report and pay taxes under chapter 82.16; (e) the sale of and charge made for the furnishing of lodging and all other services by a hotel, rooming house, tourist court, motel, trailer camp, and the granting of any similar license to use real property, as distinguished from the renting or leasing of real property, and it shall be presumed that the occupancy of real property for a continuous period of one month or more constitutes a rental or lease of real property and not a mere license to use or enjoy the same.

The term shall not include the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any publicly owned street, place, road, highway, bridge, or trestle which is used for to be used primarily for foot or vehicular traffic, nor shall it include sales of feed, seed, fertilizer,

and spray materials to persons for the purposes of producing for sale any agricultural product whatsoever, including milk, eggs, wool, fur, meat, honey, or other substances obtained from animals, birds, or insects.

"SALE AT WHOLESALE," "WHOLESALE SALE" DEFINED

RCW 82.04.060 "Sale at wholesale" or "wholesale" sale" means any sale of tangible personal property which is not a sale at retail and means any charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers: *Provided*, That the the term "real or personal property" as used in this section shall not include any natural products named in RCW 82.04.100.

"GROSS PROCEEDS OF SALES" DEFINED

RCW 82.04.070 "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property and or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

"CONSUMER" DEFINED

RCW 82.04.190 "Consumer" means the following:

(1) Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property other than for the purpose (a) of resale as tangible

personal property in the regular course of business or (b) of incorporating such property as an ingredient or component of real or personal property when installing, repairing, cleaning, altering, imprinting, improving, constructing, or decorating such real or personal property of or for consumers or (c) of consuming such property in producing for sale a new article of tangible personal property or a new substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale;

(2) Any person engaged in any business activity taxable under RCW 82.04.290;

(3) Any person engaged in the business of contracting for the building, repairing or improving of any publicly owned street, place, road, highway, bridge or trestle which is used or to be used primarily for foot or vehicular traffic as defined in RCW 82.04.280, in respect, however, only to tangible personal property used or consumed in such business;

(4) Any person who is an owner, lessee or has the right of possession to or an easement in real or personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business, excluding only the United States, the state, and its political subdivisions in respect to labor and services rendered to their real property which is used or held for public road purposes.

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No. 851

In the Supreme Court of the United States

OCTOBER TERM, 1963-64

IAN MURRAY; CEDRIC E. SANDERS; HASKELL DEVELOPMENT CO., a corporation; IAN MURRAY, INC., a corporation; KIOWA DEVELOPMENT CO., a corporation; MERCER DEVELOPMENT CO., a corporation; RICHLAND DEVELOPMENT CO., a corporation; CEDRIC SANDERS INC., a corporation; NEOSHO DEVELOPMENT CO., a corporation; SANDERS DEVELOPMENT CO., a corporation; SEDGWICK DEVELOPMENT CO., a corporation; SHAWNEE DEVELOPMENT CO., a corporation; and SHERIDAN DEVELOPMENT CO., a corporation; Copartners doing business as MURRAY-SANDERS & ASSOCIATES, and GEORGE A. FULLER COMPANY, a corporation, *Appellants*,

vs.

THE STATE OF WASHINGTON and WILLIAM S. SCHUMACHER, CLARK SQUIRE and A. E. HANKINS, as the Tax Commission of the State of Washington, *Appellees*.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

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In the

Supreme Court of the United States

OCTOBER TERM, 1963-64

No. .....

IAN MURRAY; CEDRIC E. SANDERS; HASKELL DEVELOPMENT CO., a corporation; IAN MURRAY, INC., a corporation; KIOWA DEVELOPMENT CO., a corporation; MERCER DEVELOPMENT CO., a corporation; RICHLAND DEVELOPMENT CO., a corporation; CEDRIC SANDERS INC., a corporation; NEOSHO DEVELOPMENT CO., a corporation; SANDERS DEVELOPMENT CO., a corporation; SEDGWICK DEVELOPMENT CO., a corporation; SHAWNEE DEVELOPMENT CO., a corporation; and SHERIDAN DEVELOPMENT CO., a corporation; Copartners doing business as MURRAY-SANDERS & ASSOCIATES, and GEORGE A. FULLER COMPANY, a corporation, *Appellants*,

vs.

THE STATE OF WASHINGTON and WILLIAM S. SCHUMACHER, CLARK SQUIRE and A. E. HANKINS, as the Tax Commission of the State of Washington, *Appellees*.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

JURISDICTIONAL STATEMENT

Appellants appeal from the judgment of the Supreme Court of the State of Washington, entered on August 1, 1963, which judgment became final on September 26, 1963, affirming the judgment of a state Superior Court and submit this Statement to show that the Supreme

Court of the United States has jurisdiction of the appeal and that substantial questions are presented.

OPINION BELOW

The opinion of the Supreme Court of the State of Washington is reported in — Wn.(2d) —, 384 P.(2d) 337. A copy of the opinion is attached hereto as Appendix A.

JURISDICTION

This case was brought under Revised Code of Washington, RCW 82.32.180 and RCW 82.32.150 to recover retail sales taxes paid under protest and to enjoin the appellees State of Washington and its tax commission from collecting retail sales taxes assessed against appellants in connection with the construction of military housing on a military reservation under a contract with the United States. The judgment of the Washington Supreme Court was entered on August 1, 1963, and the order denying appellants' petition for rehearing was entered on September 26, 1963. Notice of appeal was filed in the Washington Supreme Court on December 20, 1963. The jurisdiction of the Supreme Court to review this judgment by appeal is conferred by Title 28, United States Code, Section 1257(2). The following decisions sustain the jurisdiction of the Supreme Court to review the judgment on appeal in this case: *Kern Limerick, Inc. v. Scurlock*, 347 U.S. 110, 98 L.ed. 546, 74 S.Ct. 403; *U.S. v. Boyd*, Supreme Court Docket No. 1157; *General Motors Corp. v. Washington*, Supreme Court Docket No. 1071; *Livingston v. U.S.*, 179 F.Supp. 9, 364 U.S. 281, 4 L.ed.2d 1719, 80 S.Ct. 1611; *James v. United Artists Corp.*, 305 U.S. 410, 83

L.ed. 256, 59 S.Ct. 272; *Gwinn, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 83 L.ed. 272, 59 S.Ct. 325.

QUESTIONS PRESENTED

1. Is the United States the buyer, under the Washington retail sales tax statute (RCW Ch. 82.08), of military housing constructed by appellant contractors on a military reservation under a contract with the United States entered into pursuant to the Capehart Act (Amendment of August 11, 1955 to the National Housing Act, c. 783, Title IV, § 401 *et seq.*, 79 Stat. 635, as amended) rather than the so-called "mortgagor builder" corporations created by appellant contractors as required by said contract, so that said state statute is repugnant to the Supremacy Clause (Article VI, Clause 2) of the United States Constitution, when construed and applied as imposing a sales tax on said mortgagor builder corporation as the buyers, measured by the cost of such construction, and on appellant contractors for failing to collect said tax from said mortgagor builder corporations?

2. If said "mortgagor builder" corporations are the buyers of such housing under the Washington retail sales tax statute (RCW Ch. 82.08) rather than the United States, are said mortgagor builder corporations federal instrumentalities so that said state statute is repugnant to the Supremacy Clause (Article VI, Clause 2) of the United States Constitution, when construed and applied as imposing a sales tax on said mortgagor builder corporations, measured by the cost of such construction, and on appellant contractors for failing to collect said tax from said mortgagor builder corporations?

STATUTES INVOLVED

Revised Code of Washington §§ 82.08.010, 82.08.020, 82.08.030, 82.08.050, 82.04.040, 82.04.050, 82.04.060, 82-.04.070, and 82.04.190 are set forth in Appendix B hereto.

STATEMENT OF THE CASE

Appellants are contractors who constructed military housing for the United States on a military reservation located in the State of Washington under a contract with the United States entered into pursuant to the provisions of the Capehart Act. The United States, acting through the Department of the Air Force, determined that it required military housing at McChord Air Force Base and plans and specifications for the construction of such military housing were prepared by the United States. Bids for the construction were invited by the United States. Appellants submitted their bid to the United States on the required forms supplied them, together with the required bid deposit in the form of a check for $25,000.00 payable to the Treasurer of the United States. Upon being denominated the lowest acceptable bidder at a figure in excess of eight and one-half million dollars, the contract was awarded to appellants by the United States.

To enable the United States to finance the construction of the military housing, the contract between appellants and the United States obligated appellants to form six so-called mortgagor builder corporations in the State of Delaware and to cause them to be qualified as foreign corporations in the State of Washington. These corporations have identical charters in a form dictated by the United States. Each of the corporations

had exactly $1,000.00 capital which was immediately exhausted by its payment to the United States as rent under the so-called leases issued to the mortgagor builder corporations by the United States of portions of McChord Air Force Base upon which appellants were to construct the military housing. The corporations were prohibited by their charters from engaging in any business except the performance of the provisions of the documents that appellants were obligated by their contract with the United States to cause the corporations to execute. As required by the contract with the United States, resignations of the officers and directors of the corporations and all of the stock of the corporations were placed in an irrevocable escrow prior to commencement of the construction of the military housing, for ultimate delivery to the United States upon completion of the project or its sooner termination at the convenience of the United States.

Appellants were further obligated to cause these corporations to obtain a commitment from the Federal Housing Administration to insure a mortgage loan to be obtained by appellants for the entire contract price secured only by the leasehold interests of the corporations. The United States agreed in writing to repay the entire mortgage loan. Appellants obtained the mortgage loan on behalf of these corporations on the strength of the Federal Housing Administration insurance commitment and the payment agreement of the United States.

The so-called leases were for a term of 55 years, but each lease provided that as each housing unit constructed by appellants became available for occupancy,

it was to be placed under the control of the United States. The corporations were forbidden to occupy or possess the housing units.

As required by the contract with the United States, appellants, the mortgagor builder corporations, and the United States entered into a so-called housing contract, and it was at this time that all of the stock of the corporations and resignations of its officers and directors were placed in the irrevocable escrow, for delivery to the United States. The housing contract conformed to the bid made by appellants and provided that all construction should be under the supervision of the United States and that it must be accomplished in conformity with the plans and specifications furnished by the United States. Payment to appellants as the work progressed were made out of the mortgage loan funds obtained by appellants on behalf of the mortgagor builder corporations upon certificates of representatives of the United States. The housing contract expressly provided that as progress payments were made to appellants, title to the materials and work covered thereby vested in the United States, and appellants were required to waive the right to claim any lien on the project.

The United States also agreed to pay all local taxes levied upon the project, but reserved the right to contest their validity as it denied that the property was subject to such taxes. Appellants did not charge or collect retail sales taxes from the United States, the mortgagor builder corporations, or any one else in connection with the construction of the military housing at McChord Air Force Base.

The State of Washington, acting through the appellee tax commission, assessed retail sales taxes of $320,893.97 against appellants, measured by the total contract price for the military housing, under the authority of RCW 82.08.050, on the grounds that appellants should have collected retail sales taxes, measured by the total contract price, from the mortgagor builder corporations and paid the same over to the appellee tax commission.

Appellants paid a portion of the taxes assessed against them under protest and brought this action in the state Superior Court under RCW 82.32.150 and 82.32.180 to enjoin the collection of the taxes and for refund of the taxes paid. By their Complaint (R. 0003) their contentions in the Pre-Trial Order (R. 0014, 0027) and the Findings of Fact and Conclusions of Law proposed by them (R. 0051), appellants raised in the Superior Court the federal questions sought to be reviewed here. After a trial, the Superior Court held in favor of the appellees, rejected the Findings of Fact and Conclusions of Law proposed by appellants (R. 0068), and entered the Findings of Fact and Conclusions of Law submitted by appellees (R. 0030) and a Judgment (R. 0069) in their favor.

On appeal to the Washington Supreme Court, appellants raised the federal questions sought to be reviewed here in the assignments of error in their Opening Brief (R. 0080, at p. 13 *et seq.*) and in the arguments presented in that brief and in their Reply Brief (R. 0084). After two *en banc* hearings, the Washington Supreme Court, with four of the nine judges dissenting, affirmed the judgment of the Superior Court

(R. 00137, p. 609) and in construing and applying the state sales tax statute, ruled that the legal incidence of the sales tax is imposed by the statute on the "buyer" and not on the "consumer," that the "buyer" of the military housing constructed by appellants was not the United States but was rather the mortgagor builder corporations, and that the mortgagor builder corporations were not federal instrumentalities and thereby immune from state taxation.

THE QUESTIONS ARE SUBSTANTIAL

We believe that the questions presented by this appeal are substantial and that they are of public importance. This case draws in question the validity of the Washington retail sales tax statute, as construed and applied by the Washington Supreme Court, and the decision of the Washington Supreme Court was in favor of its validity. In construing the state statute, the Washington Supreme Court decided that the "buyer" and not the "consumer" is responsible for payment of the sales tax. In applying the statute as thus construed, the state court held that the United States was not the "buyer" of the military housing constructed by appellants. Federal immunity from the sales taxes in question was then completely eliminated by the determination that the mortgagor builder corporations were the "buyers" and that they were not federal instrumentalities.

1. The Capehart Act is an amendment of and supersedes the so-called Wherry Act (Aug. 8, 1949, Ch. 403, 63 Stat. 570) which in turn was an amendment of the National Housing Act. The purpose of the Wherry

Act was to encourage construction of rental housing to serve military personnel on or in the areas adjacent to military installations by providing for such housing through a special form of mortgage insurance without the necessity for the appropriation of public moneys (U.S. Code Congressional Service 1949, page 1757). The Wherry Act permitted the sale or lease of land on military installations to builders for the purpose of such construction and subsequent renting.

The basic difference between the military program provided by the Wherry Act and that provided by the Capehart Act is that under the Wherry Act the government sold or leased land to a private entrepreneur who constructed, operated and maintained the project and after construction assumed the financial risks of being able to maintain and operate the same so as to make the entire venture profitable, whereas under the Capehart Act, the project is actually built for the United States by a contractor who merely constructs the project and assumes only the financial risk of being able to complete such construction on a profitable basis and the United States thereafter assumes all risks incident to the ownership, maintenance and operation of the project.

The Capehart Act also provided for the acquisition by the Secretary of Defense of Wherry Act housing projects. The reasons for the acquisition of Wherry Act housing projects were set forth in House Report No. 2363 on the Housing Act of 1956 (U.S. Code Congressional Service 1956, page 4546 *et seq.*):

> "Your committee believes strongly in the principle that housing on or adjacent to military bases

should be owned and operated by the military department concerned. In the opinion of your committee the time has come to provide a means of transferring the ownership and operation of * * * Wherry housing to the military.

" * * * *

" * * * In many cases the rentals are too high to attract military personnel on a voluntary basis. The latter drawback will be aggravated further by the recent Supreme Court decision ruling that Wherry Act projects are subject to local taxes.

"These basic deficiencies in Wherry housing can be rectified by bringing them under the ownership and operation of the military. * * * Rentals would be lower because sponsors profit would be eliminated and because there would be no question of local tax burdens."

The recent Supreme Court opinion adverted to in the House Report was the case of *Offut Housing Co. v. County of Sarpy*, 351 U.S. 253, 100 L.ed. 1151, 76 S.Ct. 814, upholding the levy of personal property taxes by a county in the State of Nebraska on the interest of a lessee in a Wherry Act project.

In the State of Washington, both the sales tax based on the construction cost and county personal property taxes on the contractor's leasehold interest in the Wherry Act projects were upheld. *Moses Lake Homes, Inc. v. State*, 48 Wn.2d 499, 294 P.2d 1113; *Moses Lake Homes, Inc. v. Grant County*, 51 Wn.2d 285, 317 P.2d 1069. The latter decision of the Washington Supreme Court was later found to be erroneous by this Court in the case of *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 6 L.ed.2d 66, 81 S.Ct.

870, on the grounds that the county had valued the leasehold interests in a discriminatory manner.

2. Despite the pronounced differences between a Wherry Act project and a Capehart Act project, the Washington Supreme Court has upheld the imposition of the sales tax on both of them, as illustrated by *Moses Lake Homes, Inc. v. State*, *supra* (sales tax on Wherry Act project imposed) and in this case (sales tax on Capehart Act project imposed). In this case, the sales tax has been imposed on appellant contractors for failing to collect the tax from the "buyer" and pay it over to the state, even though appellants did not add the sales tax to the contract price or collect it in any manner and without regard to the fact that there is no practicable way for appellants to recover the tax from the mortgagor builder corporations, the entities determined by the Washington Supreme Court to be the "buyer" and upon whom that court held the legal incidence of the tax falls.

Two other states, Florida and Michigan, have had occasion to consider the application of a state sales tax to a Capehart Act project. Florida had also upheld the imposition of the sales tax on a Wherry Act project. *Gay v. Jemison*, 52 So.2d 137. The Supreme Courts of the states of Florida and Michigan have both held, in very similar opinions, that the sales tax does not apply to Capehart Act projects. *Green v. Eglin Air Force Base Housing, Inc.*, 104 So.2d 463 (Florida); *Knapp-Stiles, Inc. v. Michigan Department of Revenue*, 370 Mich. 629, 122 N.W.2d 642.

3. The questions presented to the Washington Su-

preme Court were federal questions, involving the validity of a Washington sales tax statute as construed and applied, and the determination of those questions was essential to the decision of that court. Three basic issues were presented to the Washington Supreme Court for determination: first, whether the legal incidence of the state retail sales tax is imposed by the statute on the "buyer" or the "consumer" where the "retail sale" involved is the performance of a construction contract; second, whether the United States was the "buyer" or "consumer" of the military housing units constructed by appellants, rather than the mortgagor builder corporations; and third, if the mortgagor builder corporations were the "buyers" or "consumers," whether these corporations were federal instrumentalities so that the federal immunity from state taxation applied.

The court ruled that the legal incidence of the sales tax is imposed by the statute not on the "consumer" but on the "buyer." The court further held that the United States was not the "buyer" but that the mortgagor builder corporations were on the strength of one sentence extracted from the many pages of documents that were required by the United States. The court stated:

> "The housing contract executed by the parties provided that 'The mortgagor builder (corporation) shall pay the eligible builder (contractor) for the performance of this Housing Contract, and all other obligations of the eligible builder herein * * *' By the express terms of the contract, the corporation, and not the United States was obligated to pay the appellant contractors; hence the

> corporation was the buyer under the statute. * * * " *Murray v. State*, — Wn.2d —, 384 P.2d 335 at 340.

The United States prescribed the use of all of the document that are exhibits in this case before the mortgagor builder corporations ever existed. The Washington Supreme Court has thus interpreted and applied the state retail sales tax statute in such a way as to eliminate in an arbitrary manner the United States as an exempt sovereign.

Having decided that the "buyer" and not the "consumer" is responsible for payment of the sales tax, and that the mortgagor builder corporations were the "buyers" of the housing units constructed by appellants and not the United States, the Washington Supreme Court completed the process of eliminating the immunity of the federal government from this case by determining that the mortgagor builder corporations were not federal instrumentalities. This latter ruling was made contrary to decisions of Florida and Michigan in *Green v. Eglin Air Force Base*, *supra*, and *Knapp-Stiles, Inc. v. Michigan Department of Revenue*, *supra*, and the cases of *Clallam County v. United States*, 263 U.S. 341, 68 L.ed. 328, 44 S.Ct. 121, and *Livingston v. U.S.*, 179 F.Supp. 9, affirmed on the merits by the Supreme Court, 364 U.S. 281, 4 L.ed.2d 1719, 80 S.Ct. 1611.

Furthermore, in deciding that the mortgagor builder corporations were not federal instrumentalities, the Washington Supreme Court relied on *DuPont de Nemours & Co. v. State*, 44 Wn.2d 339, 267 P.2d

667, a case that was in essence overruled by this Court by its decision in *Livingston v. U.S., supra.*

4. The question whether the United States was the "buyer" of the military housing constructed by appellants is basically the same issue that was presented to this Court in *Kern Limerick, Inc. v. Scurlock, supra.* That case followed the more well-known case of *Alabama v. King & Boozer*, 314 U.S. 1, 86 L.ed. 3, 62 S.Ct. 43. In the *King & Boozer* case, this Court held that the legal incidence of the sales tax there in question did not fall on the United States. In *Kern Limerick* this Court reviewed the *King & Boozer* case (which has been relied upon by appellees throughout in this case and also by the Washington Supreme Court) and particularly a statement made in the latter case to the effect that "Who, in any particular transaction like the present, is a 'purchaser' within the meaning of the statute is a question of state law on which only the Supreme Court of Alabama can speak with final authority. *Id* 314 U.S. at 9, 10." Regarding that statement, this Court said in the *Kern Limerick* case:

> "Read literally, one might conclude this court was saying that the state court might interpret its tax statute so as to throw tax liability where it chose, even though it arbitrarily eliminated an exempt sovereign. *Such a conclusion as to the meaning of the quoted words would deny the long course of judicial construction which establishes as a principle that the duty rests on this court to decide for itself facts or constructions upon which federal constitutional issues rest.* The quotation refers, we think, only to the power of the state court to determine who is responsible under its law for

> the payment to the state of the exaction. * * * " *Id* 347 U.S. at 121, 122. (Emphasis supplied)

The duty rests on the Court in this case to decide for itself the facts and constructions upon which the federal constitutional issues here presented rest.

The Washington Supreme Court has denied the contention of appellants that the United States was the buyer of the military housing constructed by appellants just as the Arkansas Supreme Court held that the United States was not the purchaser in the *Kern Limerick* case. The Washington Supreme Court upheld the validity of the state retail sales tax statute, as construed and applied to this Capehart Act construction, just as the Arkansas Supreme Court upheld the validity of the Arkansas sales tax statute, as construed and applied to the facts presented by the *Kern Limerick* case. The appeal of the *Kern Limerick* case is authority for the appeal of this case.

5. The questions presented here concern not only the Congressional method for financing the construction of much needed military housing under the provisions of the Capehart Act but also the power of a state to impose taxes on a federal project performed on a federally owned military reservation. The objectives of Congress under the Wherry Act program had been defeated in part by the imposition of state and local tax burdens. Congress enacted the Capehart Act to eliminate these problems. But the decision of the Washington Supreme Court in this case frustrates the Congressional objectives.

It is difficult to conceive of a project more federal

in character than a Capehart Act project. The need for the housing is decided by the United States. The United States prepares and furnishes the plans and specifications. Construction bids are invited by the United States. The United States selects the successful bidder and contracts with him. The land upon which the housing is constructed is owned by the United States. Construction is supervised by the United States. Private construction funds are obtained on the strength of the insurance and payment obligations of the United States. The United States alone occupies, maintains and uses the housing. Despite all these elements, the Washington Supreme Court has ruled that the military housing was actually constructed by appellants for private corporations, that the private corporations bought the housing, not the United States, and that the mortgagor builder corporations were not federal instrumentalities because they served "a separate and distinct function from that of the United States." *Murray v. State*, 384 P.2d 337 at 342. The Washington Supreme Court implied that somehow the mortgagor builder corporations were performing a function or purpose of their own. Such a conclusion is clearly untenable. Since the cost of fulfilling the urgent need for military housing was so great that it could not be accomplished by direct appropriations that would be reflected immediately in the budget, Congress determined upon a method of utilizing private loans in the first instance, with the loans to be repaid by the United States on the installment plan out of appropriated quarters allowances for military personnel. The means for effectuating this Congressional policy were the

mortgagor builder corporations. That was their only function—to accomplish the federally conceived and federally implemented financing program for a project that was completely federal in all of its essential aspects.

Flexibility in financing federal projects is both necessary and desirable. Such flexibility will be seriously impaired if the decision of the Washington Supreme Court is allowed to stand. A worthwhile Congressional policy of utilizing private capital in the construction of federal projects will also suffer a setback if the use of financing agents, such as the mortgagor builder corporations, destroys the federal character of the function being performed by them. The decision of the Washington Supreme Court has this effect, for the state court held that the mortgagor builder corporations were not federal instrumentalities.

The *Clallam County* and *Livingston v. United States* cases, *supra*, support the contention of appellants that the function performed by the entity is crucial to the determination of whether it is a federal instrumentality. If its sole function is to fulfill a federal purpose, it is a federal instrumentality, regardless of the federal ownership or the lack of it. In the *Livingston* case, E. I. duPont de Nemours & Co. was held to be a federal instrumentality because it was performing a federal purpose and yet the private character of its ownership cannot be questioned. The *Clallam County* case involved a corporation formed pursuant to an Act of Congress and that corporation in all of its basic aspects was quite similar to the mortgagor builder corporations.

Appellees elected to proceed against appellant contractors, rather than the mortgagor builder corporations as the "buyers," which would be the normal approach, for obvious reasons. The only assets of these corporations was the so-called lease which gave them no rights to possess, occupy or control the real property leased or the military housing constructed thereon by appellants. A judgment against the mortgagor builder corporations would therefore be worthless.

In addition to the reasoning advanced herein, appellants adopt the reasons set forth in the jurisdictional statements in the companion cases that were consolidated with this case before the Washington Supreme Court.

The questions presented by this appeal we believe to be substantial and of public importance.

Respectfully submitted,

BOGLE, BOGLE & GATES
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Counsel for Appellants.

14th Floor Norton Building,
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PROOF OF SERVICE

I, RICHARD S. SPRAGUE, an attorney in the office of Bogle, Bogle & Gates, attorneys of record for Ian Murray *et al.*, appellants herein, depose and say that on the 15th day of February, 1964, I served a copy of the foregoing Jurisdictional Statement on the State of Washington, *et al.*, appellees herein, by depositing the same in a United States mail box, with first class postage prepaid, addressed to counsel of record at their post office address in Olympia, Washington.

Richard S. Sprague

Subscribed and sworn to before me this 15th day of February, 1964.

Notary Public in and for the State of Washington, residing at Seattle.

APPENDICES
A AND B

Appendix A—Opinion of the Supreme Court of the State of Washington App. A, pages 3 to 24

Appendix B—Statutes Involved App. B, pages 1 to 13

APPENDIX A

OPINION OF THE SUPREME COURT OF THE STATE OF WASHINGTON

[Nos. 36226, 36227, 36228, 36229. En Banc. August 1, 1963]

IAN MURRAY *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *et al.*, *Appellants*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.

HEBB & NARODICK CONSTRUCTION CO., INC., *Appellant*, v. THE STATE OF WASHINGTON *et al.*, *Respondents*.*

Consolidated appeals from judgments of the Superior Court for Thurston County, Nos. 32176, 32186, 32195, 32196, Charles T. Wright, J., entered July 3, 1961. *Affirmed*.

Consolidated actions to recover taxes paid under protest. Plaintiffs appeal from judgments in favor of the defendant.

Bogle, Bogle & Gates, Edward G. Dobrin, and *Richard S. Sprague*, for appellants Murray *et al.*

Allen, DeGarmo & Leedy and *Seth W. Morrison*, for appellants Inland Empire Builders, Inc., *et al.*

Casey & Pruzan, by *Carl Pruzan*, for appellants Hebb & Narodick Construction Co., Inc., *et al.*

The Attorney General, John W. Riley, Chief Assistant, and *Timothy R. Malone, Assistant*, for respond-

OTT, C. J.—This appeal is a consolidation of four actions brought by several contractors to recover a retail sales tax paid under protest, and to enjoin the State Tax Commission from assessing the sales tax in connection with the construction of Capehart Act housing at military installations in Washington.

From adverse judgments, the contractors appeal.

The facts upon which these appeals are predicated are not in dispute. The legal issue involved is whether the transactions, pursuant to which the military housing was constructed, are shielded from state taxation by the sovereign immunity granted to the United States government by the federal and state constitutions.

Each of the appellants was awarded contracts under the provisions of the Capehart Act (69 Stat. 651-654 as amended). Since the contract provisions are identical, we will refer only to the material portions of the documents in cause No. 36226. The procedure for the execution of a contract under the act, in so far as here material, may be stated as follows:

The Secretary of Defense, after determining a need for military housing, issues an invitation for bids. The contractor submitting the lowest acceptable bid receives a "Letter of Acceptability" from the Secretary. The letter requires the successful bidder to establish a private "mortgagor-builder" corporation under the laws of the state of Delaware, and to qualify it to do business in the state involved. The contractor furnishes the corporation with $1,000 for capital stock, purchases all of it, and elects its officers and directors. The United States government executes to the corporation a 55-

year lease of the real estate upon which the housing is to be constructed. The corporation is to obtain private financing by giving a mortgage on its leasehold, and obtain a commitment from the Federal Housing Administration to insure its mortgage loan. The mortgage loan in is the amount of the contractor's bid.

The "Letter of Acceptability" prescribes the "initial closing" procedure, which entails the execution of the following documents:

(1) The 55-year lease between the United States and the corporation for a consideration of $1,000, paid by the corporation to the United States government. The corporation agrees, during the period of construction, to maintain insurance and to save the United States government harmless from many laws, ordinances, and regulations applicable to the leased premises, with regard to construction, sanitation, licenses or permits to do business.

(2) The corporation executes a note, secured by a real and chattel mortgage on its real-estate leasehold, to the private lender.

(3) The corporation, contractor, and the United States execute a housing contract which provides that all construction is to be inspected and supervised by the United States; that progress payments are to be made by the corporation from the mortgage loan, upon request of the contractor and approval of the United States, and that, upon full payment, title to the housing units vests in the United States, subject to contractor liability for latent defects. The contract further provides that the contractor shall act as agent for the cor-

poration, guarantee its performance, and furnish a performance bond to the corporation and the mortgagee.

(4) An irrevocable escrow agreement is executed which provides that the resignations of the officers and directors of the corporation, and the stock certificates of the corporation, endorsed in blank, are to be placed in escrow, with instructions to the escrow holder to deliver these documents to the United States upon completion and acceptance of the project.

(5) The United States executes a written guarantee to pay the mortgage installment payments to the private mortgagee and/or the Federal Housing Administration, the insurer.

The provisions of the Capehart Act were fully complied with by the contractors involved in these appeals.

Appellants' assignments of error raise two principal issues: First, the appellant contractors contend that, under Washington law, the consumer of the housing project is the party liable for payment of the sales tax, and that, as a result of the statutory method for the construction of Capehart housing, the United States is the consumer and, therefore, its constitutional immunity from state taxation applies. Secondly, appellants contend that the mortgagor-builder corporation is an agency of the United States and, as such, is immune from state tax.

[1] The function of interpreting state statutes to determine who is liable for payment of a sales tax is reserved to the state courts involved. *Alabama v. King & Boozer,* 314 U.S. 1, 86 L.Ed. 3, 62 S.Ct. 43, 140 A.L.R.

615 (1941); *Kern-Limerick, Inc., v. Scurlock*, 347 U.S. 110, 98 L.Ed. 546, 74 S.Ct. 403 (1954).

RCW 82.08.020 provides that " . . . there shall be collected a tax on each retail sale in this state . . . " A retail sale is defined in RCW 82.04.050 as including

" . . . the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following: . . . (b) the constructing . . . of new or existing buildings or other structures under, upon, or above real property *of or for consumers*, . . . " (Italics ours.)

A consumer is defined in RCW 82.04.190(4) as "Any person who is an *owner, lessee or has the right of possession* to or an easement in real or personal property . . . " (Italics ours.)

RCW 82.08.050 provides in part:

"The tax hereby imposed shall be paid by the *buyer* to the seller, and each *seller* shall collect from the *buyer* the full amount of the tax payable in respect to each taxable sale . . .

"In case any seller fails to collect the tax herein imposed . . . he shall . . . be personally liable to the state for the amount of the tax." (Italics ours.)

Appellants concede that a retail sale, as defined in RCW 82.04.050, did occur, but contend that the consumer defined in RCW 82.04.190, and the buyer denominated in RCW 82.08.050 are synonymous, and that the United States government is the consumer and taxable party because it becomes the owner of the housing units upon their completion and acceptance.

[2] With this contention, we do not agree. One of the purposes of RCW 82.04.050 is to define the event that gives rise to a taxable transaction, which is the rendition of labor and services in the construction of new buildings upon real property of or for consumers. RCW 82.04.190 establishes the means by which the consumer is identified. These sections do not designate the party liable for payment of the tax in any given transaction. RCW 82.08.050 provides that the retail sales tax shall be borne by the buyer, who is primarily liable for payment of the tax. *Kaeser v. Everett*, 47 Wn.(2d) 666, 289 P.(2d) 343 (1955).

We must therefore determine who is the buyer under the facts of the instant case. In this regard, appellants contend that the United States is the buyer because it bears the economic burden of paying for the military housing, by virtue of its guarantee of the mortgage obligation.

In *Alabama v. King & Boozer*, *supra*, the state of Alabama, pursuant to a statute which imposed the sales tax upon the purchaser, levied a sales tax upon the sale of lumber to a contractor who was constructing installations for the Army. It was there contended that the sales tax could not be collected from the contractor for the reason that the United States was the purchaser, within the meaning of the Alabama statute. In answering this contention, the Supreme Court of the United States held:

" . . . The taxing statute, as the Alabama courts have held, makes the 'purchaser' liable for the tax to the seller, who is required 'to add to the sales price' the

amount of the tax and collect it when the sales price is collected, whether the sale is for cash or on credit. Who, in any particular transaction like the present, is a 'purchaser' within the meaning of the statute, is a question of state law on which only the Supreme Court of Alabama can speak with final authority. ***But it seems plain, as the Government concedes and as we assume for present purposes, that under the provisions of the statute the purchaser of tangible goods who is subjected to the tax measured by the sales price, is the person who orders and pays for them when the sale is for cash or who is legally obligated to pay for them if the sale is on credit....*** " (Italics ours.)

The court concluded:

"We cannot say that the contractors were not, or that the Government was, bound to pay the purchase price, or that the contractors were not the purchasers on whom the statute lays the tax. The added circumstance that they were bound by their contract to furnish the purchased material to the Government and entitled to be reimbursed by it for the cost, including the tax, no more results in an infringement of the Government immunity than did the tax laid upon the contractor's gross receipts from the Government in *James v. Dravo Contracting Co., supra* [302 U.S. 134]."

[3, 4] Applying this rule, the buyer is the person who is *legally obligated* to pay the seller in any transaction. The housing contract executed by the parties provided that "The mortgagor-builder [corporation] shall pay the eligible-builder [contractor] for the performance of this Housing Contract, and all other obligations of

the eligible builder herein, . . . " By the express terms of the contract, the corporation, and not the United States, was obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. Under the provisions of the Capehart Act and the facts in the instant case, the United States government was not obligated to pay the seller. The fact that the ultimate economic burden of the tax may fall upon the United States does not vitiate a state tax on the transactions. *Alabama v. King & Boozer, supra; Kern-Limerick, Inc., v. Scurlcok, supra; United States v. Detroit,* 355 U.S. 466, 2 L.Ed.(2d) 424, 78 S.Ct. 474 (1958); *E. I. Du Pont de Nemours & Co. v. State,* 44 Wn.(2d) 339, 267 P.(2d) 667 (1954).

Our conclusion in this regard is also supported by the following cases:

United States v. Harrison & Grimshaw Constr. Co., 305 F.(2d) 363 (1962), involved the question of whether the provisions of the Miller Act applied to the performance bond given by the eligible builder under a Capehart Act contract. The court held (p. 368):

" . . . The projects are of a private nature until completition and assumption of control by the government. *The mortgagor-builder has a contract with a construction company to build the project. The constructor looks to the mortgagor-builder for payment for his work and owes to the mortgagor-builder the obligation to perform. . . .* " (Italics ours.)

In *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York,* 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), it was said:

"Likewise, we must reject appellant's contention that the subject mortgages, as direct obligations to the United States, are immune from State or local taxation, as provided in section 3701 of the Revised Statutes of the United States (U. S. Code, tit. 31, § 742) which exempts 'Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States' since they are not 'of the same type as those specifically enumerated' in the statute (*Smith v. Davis*, 323 U.S. 111, 117). Under the arrangement authorized by the Enabling Act, it is clear that the device employed was designed to relieve the Government of its financially burdensome obligation to provide housing for its military personnel and at the same time avoid increasing the national debt. It did not pledge its credit in the usual sense, but merely guaranteed each 'periodic payment' based on a monthly average of $90 per family unit."

Congress, in its discretion, by enacting the Capehart law, chose to leave the hazards of construction, the purchasing of proper materials, and the furnishing of proper labor performance to private contractors and private lenders. It chose to guarantee only the payment to the private lender, after units acceptable to the government were erected upon the leased premises. We conclude, therefore, that the mortgagor-builder corporation was the party legally obligated to pay the contractor, and that it was the buyer denominated in RCW 82.08.050.

Is the mortgagor-builder corporation an agency of the United States?

Appellants contend that title to the units, when built in accordance with the contracts, vested in the United States; that the United States controlled and dictated the terms of the construction contracts, and that it guaranteed the mortgage obligation and ultimately gained ownership of all of the corporation's capital stock; hence, the corporation is a government agency.

In support of this contention, appellants rely on *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923); *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958); and *Knapp-Stiles, Inc., v. Michigan Department of Revenue*, CCH 2 Mich. Tax Cases ¶¶ 200-202 (1962).

The *Clallam County* case held that a corporation, organized pursuant to a World War I emergency act which authorized the Director of Aircraft Production to establish one or more state corporations to produce war materials, was an agency of the United States and, as such, its activities were exempt from state taxation. The case is not apropos. The Director of Aircraft Production was, by law, an agent of the government. In the instant case, the successful bidders were not authorized agents of the government. Furthermore, the facts in the cited case did not disclose any evidence of an intent to distinguish the corporate activities from those of the United States. In this regard, the court stated (p. 345): " . . . This is not like the case of a corporation having its own purposes as well as those of the United States . . . "

In the *Green* case, the court stated (p. 467):

" ' . . The question here is the extent of an *exemp-*

tion granted by *state statute*. Had the legislature intended to limit the exemption to that required by the Federal Constitution there would have been no occasion whatever to go further than to say "There shall also be exempted all sales made to the United States." But the legislature intended to grant a greater exemption and made that intent clear . . . ' "

In *Knapp-Stiles, Inc., v. Michigan Department of Revenue, supra,* the court stated:

"At the outset, it may be noted that the question is *not* whether the State has the *power* to impose such tax upon contractors who are performing contracts with the United States.

" . . .

"Michigan has the power to impose such a tax. Has it done so? Or has it, by the language of the statute, exempted the sales here involved from the tax? . . . "

In the *Green* and *Knapp-Stiles* cases, the result was determined by interpreting a state exemption statute much broader than our own, for which reason the cases are distinguishable.

[5] The mortgagor-builder corporate entity created for the purpose of constructing and financing Capehart housing serves a separate and distinct function from that of the United States. That such a corporation is not an agency of the United States is sustained by the following decisions:

In *In re S. S. Silberblatt, Inc., v. Tax Commission of the State of New York, supra,* the New York Court of Appeals held that the mortgagor-builder corporation

was subject to that state's mortgage recording tax, stating (p. 641):

"The appellant's contention that this petitioner and the five corporate mortgagors are instrumentalities of the Federal Government or its agencies and, as such, are exempt from State and local taxation, is without substance. . . . At the time of the execution, delivery and recording of these mortgages, each of the mortgagors was a private corporation, all of the capital stock of which was privately owned. They were created for a commercial purpose for private profit, as distinguished from a governmental purpose. In the absence of statute to the contrary, it may not be assumed that a governmental function was involved. They possess all of the requisites and responsibilities of corporate existence and, as such, *are an entity separate and apart from the United States* (*United States v. Strang*, 254 U.S. 491) *and this is so, notwithstanding the fact that all of the capital stock of each corporation will ultimately be owned by the Federal Government* (*Sloan Shipyards v. United States Fleet Corp.*, 258 U.S. 549, 42 S.Ct. 386, 66 L.Ed. 762) . . ." (Italics ours)

In *United States v. Ft. George G. Meade Defense Housing Corp. No. 1*, D.C., 186 F.Supp. 639 (1960), it was held that the leasehold interest acquired by the mortgagor-builder corporation from the United States was subject to the Maryland mechanics' lien law because

" . . . the so-called Capehart Act contemplates leaving the entire arrangement for the financing and construction of Capehart housing projects in the hands of

private enterprise until the point at which the government has secured the capital stock of the Housing Corporation . . . "

The reasoning in the following cases, although not arising from Capehart transactions, supports the view that the mortgagor-builder corporations are not agencies of the government.

In *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn. (2d) 339, 267 P.(2d) 667 (1954), it was contended that the Du Pont Company was an agent or instrumentality of the United States in its operation of the Hanford Engineer Works. We held (pp. 349, 350):

" . . . the fact that the government reserved and exercised the right to restrict or control the action of the contractor as to its general activities does not establish the existence of an agency relationship. . . .

" . . .

"It is also without significance that all of the real and personal property utilized in performing the contract was owned by the government. [Citing cases.] The same is true with regard to the fact that the government exerted unusual supervisory controls over every phase of the contractor's activity. [Citing case.]"

In *United States v. Brown*, D.C., 41 F.Supp. 838 (1941), the contention was rejected that certain Regional Agricultural Credit Corporations, created pursuant to federal enactment, were immune from state taxation because the United States owned all of the capital stock of the corporations. The court said (p. 840):

"Whether or not these Regional Corporations shall enjoy sovereign immunity from taxation is wholly a

question of Congressional intent. They are purely commercial corporations exercising no sovereign function. In the absence of statutory provision, there is no reason why they should be exempted from taxation, especially in view of Congressional policy concerning this type of corporation, evidenced by many statutory provisions expressly subjecting the real property of similar corporations to taxation.

"The mere fact that the United States owns all the capital stock of these corporations is not alone sufficient to endow them with sovereign immunity, nor do they acquire such immunity merely because they are the medium through which the Government carries out certain proprietary activities. Note, 83 L.Ed. 799 et seq.

" . . .

"When a corporation is created for commercial as distinguished from Governmental purposes, it is ordinarily implied in the absence of statutory provisions to the contrary, that such corporation shall have all the requisites and responsibilities of corporate existence, even though the United States owns all the stock. Such a corporation is an entity separate from the United States. *United States v. Strang*, 254 U.S. 491, 41 S.Ct. 165, 65 L.Ed. 368."

We conclude that the mortgagor-builder corporation, having served an independent and distinct purpose in the taxable event, is not a federal agency.

Further, Congress has not expressed a legislative intent to immunize a Capehart corporation from state taxation. The invitations to bid expressly provided:

"Nothing in this Invitation for Bids shall be deemed

to relieve the eligible builder of any liability for the payment of sales or use taxes properly levied."

For the reasons stated, the sales tax was "properly levied" upon these transactions. Appellants, under the statute, were obligated to collect the tax from the mortgagor-builder corporations. Having failed to collect it, appellants are liable for the tax. RCW 82.08.050, *supra*.

The judgments are affirmed.

FINLEY, ROSELLINI, HAMILTON, and HALE, JJ., concur.

HUNTER, J. (dissenting)—The majority say that the sales tax must fall upon the person legally obligated to pay for construction of the military housing. With this I agree.

The majority then state that, by the express terms of the contract with the mortgagor-builder, the Delaware corporation, and not the United States was legally obligated to pay the appellant contractors; hence, the corporation was the buyer under the statute. The fact that the ultimate economic burden of the tax may fall upon the United States does not constitute it as the person legally obligated to pay the tax. Neither do I disagree with this rationale.

It is my disagreement with the majority in the disposition of the issue relating to whether the mortgagor-builder corporation is an instrumentality of the United States that bring me to a result contrary to that of the majority in this case.

Under the established rule for the construction of contracts, a contract must be picked up by its four

corners and considered in its entirety. In so doing, it is inescapable to conclude other than that the prime purpose of the housing contract was the construction of military housing for the exclusive use of the United States. It was necessarily the obligation of the government to pay for this housing and, although it did not wish to be directly obligated, the United States, in causing the Delaware corporation to be organized, did so to provide a means to carry out its obligation to compensate the contractors for the construction of this housing.

In *Clallam County v. United States*, 263 U.S. 341, 68 L.Ed. 328, 44 S.Ct. 121 (1923), it was held that a corporation created for the purpose of operating a sawmill and railroad for the promotion of the war effort and wholly owned by the United States was an instrumentality of the United States. The court there said:

"In short the Spruce Production Corporation was organized by the United States an an instrumentality for carrying on the war, all its property was conveyed to it by or bought with money coming from the United States and *was used by it solely as means to that end*, and when the war was over it stopped its work except so far as it found it necessary to go on in order to wind up its affairs. . . .

" . . .

"The State claims the right to tax on the ground that taxation of the agency may be taxation of the means employed by the government and invalid upon admitted grounds, but that taxation of the property of the agent is not taxation of the means. We agree that it

'is not always, or generally, taxation of the means,' as said by Chief Justice Chase in *Thomson v. Pacific Railroad*, 9 Wall 579, 591. But it may be, and in our opinion clearly is when as here not only the agent was created but all the agent's property was acquired and used, for the sole purpose of producing a weapon for the war. *This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account. The incorporation and formal erection of a new personality was only for the convenience of the United States to carry out its ends. . . .* " (Italics mine.)

Contemporaneous with the signing of the housing contract, the stock of the corporation in the instant case was irrevocably placed in escrow, together with the resignation of the officers and directors, to be delivered to the United States at the conclusion of the construction of the housing. There was no possible contingency for the return of the stock to the stockholders or the documents of resignation to the officers and directors. The corporation owned nothing of any value in the housing being constructed. It served solely as a means to the end of obtaining military housing for the United States. There was no possibility for it to engage in any purpose other than to serve the end of obtaining military housing for the United States on this exclusive project. Because it had no purposes independent of those of the United States, the corporation was nothing more than an instrumentality thereof.

The appellants cite *Green v. Eglin AFB Housing, Inc.*, 104 So.(2d) 463 (Fla. 1958), which is persuasive

of their contention. There, under the authority of the Capehart Act, the government entered into a contract virtually identical with that of the instant case for the construction of military housing at the Eglin Air Force Base in Florida. The Florida court in effect found that the Delaware corporations were government instrumentalities, stating:

"'The AFB corporations were created at the direction of the United States for the sole purpose of borrowing money to be expended in constructing facilities needed by the United States, to be repaid by the United States and further securing the payment of this money by a mortgage upon property of the United States. These corporations will continue in existence until the mortgage debts are paid, so as to provide a party against whom the mortgages may be foreclosed in the remote contingency that the United States defaults in its obligation to pay the mortgage debt.

"'Even if we regard the AFB corporation as private enterprises, their interest in the property is so neglible —lessees without right of use or possession—as to make it entirely unrealistic to hold that it destroys the status of these buildings as a part of the public works of the United States.

"'It is very doubtful if these corporations should be regarded as anything other than agencies or instrumentalities of the Federal Government. In *Clallam County, Wash. v. United States*, 263 U.S. 341, 44 S.Ct. 121, 68 L.Ed. 328, the Supreme Court held that a corporation created for the purpose of operating a sawmill and railroad in the promotion of the war ef-

fort during the first World War and which was wholly owned by the United States was an agency of the United States and that its property was, therefore, immune from state taxation. In describing the corporation there involved the [sic] used language peculiarly applicable to each AFB corporation: "The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends." The creation of the AFB corporations was only for the convenience of the United States to enable it to finance military construction in a manner determined by the Congress to be most conducive to the national interest. . . . ' "

The limited function of the Delaware corporation, its power and purpose are aptly stated by the Michigan court in *Knapp-Stiles, Inc., v. Michigan Department of Revenue,* CCH 2 Mich. Tax Cases ¶ 200-202 (1962). There, as here, the contracts were for military housing under the Capehart Act. The court said relative to the corporations ■

" . . . In the Invitation for Bids, which is prepared and issued by the United States, acting through the Department of the Air Force, there is found in Paragraph 1, above quoted, the following:

" 'The statute further contemplates that the Government-owned housing site be leased to a mortgagor or borrower corporation *which will act as a channel* for the proceeds of the mortgage loan from the lender to the successful bidder . . . '

"And a review of the documents—the lease, the contract, and the mortgage is convincing that this is sub-

tantially the only function that the Delaware corporation do perform.

"They have no real powers except to do the bidding of the United States. . . .

" . . .

"The corporations do not determine the terms of the contract. That is all done before the corporations come into existence. They do not determine whether the contract has been performed. They cannot modify its terms. They cannot terminate it.

"True, the corporations had a lease upon the premises. While this is nominally for a fifty-five year term, in fact, the actual possession, maintenance and operation of the housing is in the hands of the United States and its Air Force as soon as the housing is ready for occupancy.

"The United States alone determines the terms of the contract. It alone can modify or terminate it. It alone determines when it has been performed."

An analysis of *In re S. S. Silberblatt, Inc., v. Tax Comm. of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959) cited by the majority, discloses that the opinion is based on the erroneous premise that the Delaware corporations were " . . . created for a commercial purpose for private profit, as distinguished from a governmental purpose." As heretofore stated, consideration of the housing contract in its entirety cannot support such a conclusion. The analysis of the housing contract and the reasoning of the dissent in the *Silberblatt* case is correct.

" . . . Although under our State law the tax is imposed upon the recording of the mortgage (*Franklin Soc. v. Bennett*, 282 N.Y. 79), this case is controlled by Federal law under which the tax is on the mortgage itself, which is a Federal instrumentality exempt from State taxation (*Federal Land Bank v. Crosland*, 261 U.S. 374; . . .). Unlike the Wherry Act, the Capehart Act, under which this military housing project was authorized, renders petitioner-appellant merely a builder and not a private sponsor of the military housing. The United States, through its Department of Defense, is the sponsor, financier and owner of the entire project. The mortgagor corporations are mere fictions, and they and the mortgagee banks had no other function in this business than to act as agents for the Federal Government (*Clallam County v. United States*, 263 U.S. 341, 345, 44 S.Ct. 121, 68 L.Ed. 328; *Railroad Co. v. Peniston*, 18 Wall 5, 42, 85 U.S. 5, 42, 21 L.Ed. 787) . . . "

The majority attempt to distinguish the *Clallam County* case on the basis that the corporation there had no purpose other than to produce war materials for the United States government, and it quotes from the *Clallam County* case as follows:

" ' . . . This is not like the case of a corporation having its own purposes as well as those of the United States. . . . ' "

The inference from this quotation which is desired by the majority is that the Delaware corporation had purposes other than those of the United States government. This is erroneous and unsupported by the record.

The holding of the cases cited by the majority, *E. I. Du Pont de Nemours & Co. v. State*, 44 Wn.(2d) 339, 267 P.(2d) 667 (1954), and *United States v. Brown*, 41 F.Supp. 838 (1941), is not inconsistent with the *Clallam County* case since the corporations, in those cases, were not instrumentalities of the United States because they had separate commercial purposes for private profit.

In the instant case we should hold that, although the mortgagor-builder is the "buyer" to whom the retail sale of the housing project construction was made, it was nothing more than an instrumentality of the United States government; that it had no commercial purpose other than for the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the federal government applies.

The judgment of the trial court should be reversed, and the cause remanded with instructions to enter judgment restraining the Tax Commission from imposing the tax and to permit recovery of the tax which appellants paid under protest.

HILL, DONWORTH, and WEAVER, JJ., concur with HUNTER, J.

APPENDIX B

STATUTES INVOLVED

Revised Code of Washington

RCW 82.08.010 Definitions. For the purposes of this chapter:

(1) "Selling price" means the consideration, whether money, credits, rights, or other property, expressed in the terms of money paid or delivered by a buyer to a seller, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer;

(2) "Seller" means every person making sales at retail or retail sales to a buyer or consumer, whether as agent, broker, or principal;

(3) "Buyer" and "consumer" include, without limiting the scope hereof, every individual, receiver, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise, municipal corporation, quasi municipal corporation, and also the state, its departments and institutions and all political subdivisions thereof, irrespective of the nature of the activities engaged in or

functions performed, and also the United States or any instrumentality thereof;

(4) The meaning attributed in chapter 82.04 to the terms "tax year," "taxable year," "person," "company," "sale," "sale at retail," "retail sale," "sale at wholesale," "wholesale sale," "business," "engaging in business," "cash discount," "successor," "consumer," "in this state" and "within this state" shall apply equally to the provisions of this chapter. . . .

RCW 82.08.020 Retail sales tax imposed. There is levied and there shall be collected a tax on each retail sale in this state equal to three and one-third per cent of the selling price: *Provided*, That from April 1, 1959 the tax imposed by this section shall be equal to four per cent of the selling price. The tax imposed under this chapter shall apply to successive retail sales of the same property and to the retail sale of intoxicating liquor by the Washington state liquor stores. . . .

RCW 82.08.030 Exemptions. The tax hereby levied shall not apply to the following sales:

(1) Casual and isolated sales of property or service, unless made by a person who is engaged in a business activity taxable under chapters 82.04., 82.16 or 82.28: *Provided*, That the exemption provided by this paragraph shall not be construed as providing any exemptio nfrom the tax imposed by chapter 82.12;

(2) Sales made by persons in the course of business activities with respect to which tax liability is specifically imposed under chapter 82.16, when the gross proceeds from such sales must be included in the measure of the tax imposed under said chapter;

(3) The distribution and newsstand sales of newspapers;

(4) Sales which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(5) Sales of motor vehicle fuel used in aircraft by the manufacturer thereof for research, development, and testing purposes and sales of motor vehicle fuel taxable under chapter 82.36: *Provided*, That the use of any such fuel upon which a refund of the motor vehicle fuel tax has been obtained shall be subject to the tax imposed by chapter 82.12;

(6) Sales (including transfers of title through decree of appropriation) heretofer or hereafter made of the entire operating property of a publicly or privately owned public utility, or of a complete operating integral section thereof, to the state or a political subdivision thereof for use in conducting any business defined in subdivisions (1), (2), (3), (4), (5), (6), (7), (8), (9), (10) or (11) of RCW 82.16.010;

(7) Auction sales made by or through auctioneers of tangible personal property (including household goods) which have been used in conducting a farm activity, when the seller thereof is a farmer and the sale is held or conducted upon a farm and not otherwise;

(8) Sales to corporations which have been incorporated under any act of the congress of the United States and whose principal purposes are to furnish volunteer aid to members of armed forces of the United States and also to carry on a system of national and international relief and to apply the same in mitigat-

ing the sufferings caused by pestilence, famine, fire, floods, and other national calamities and to devise and carry on measures for preventing the same;

(9) Sales of purebred livestock for breeding purposes where the animals are registered in a nationally recognized breed association; sales of cattle and milk cows used on the farm;

(10) Sales of tangible personal property (other than the type referred to in subdivision (11) hereof) for use by the purchaser in connection with the business of operating as a private or common carrier by air, rail, or water in interstate or foreign commerce: *Provided,* That any actual use of such property in this state shall, at the time of such actual use, be subject to the tax imposed by chapter 82.12;

(11) Sales of airplanes, locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state; also sales of tangible personal property which becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers used by the holder of a carrier permit issued by the Interstate Commerce Commission authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; also sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving;

(12) Sales of motor vehicles and trailers to be used for the purpose of transporting therein persons or property for hire in interstate or foreign commerce: *Provided*, That the purchaser must be the holder of a carrier permit issued by the Interstate Commerce Commission and that the vehicles will first move upon the highways of this state from the point of delivery in this state to a point outside of this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100;

(13) Sales of motor vehicles and trailers to nonresidents of this state for use outside of this state, even though delivery be made within this state, but only when (a) the vehicles or trailers will be taken from the point of delivery in this state directly to a point outside this state under the authority of a one-transit permit issued by the director of licenses pursuant to the provisions of RCW 46.16.100, or (b) said motor vehicles and trailers will be registered and licensed immediately under the laws of the state of the purchaser's residence, will not be used in this state more than three months, and will not be required to be registered and licensed under the laws of this state.

(14) Sales to nonresidents of this state for use outside of this state of tangible personal property which becomes a component part of any machinery or other article of personal property belonging to such nonresident, in the course of installing, repairing, cleaning, altering, or improving the same and also sales of or charges made for labor and services rendered in respect to any installing, repairing, cleaning, altering, or

improving, of personal property of or for a nonresident, but this subsection (14) shall apply only when the seller agrees to, and does, deliver the property to the purchaser at a point outside this state, or delivers the property to a common or bona fide private carrier consigned to the purchaser at a point outside this state;

(15) Sales to nonresidents of this state for use outside of this state of watercraft requiring coast guard registration or registration by the state of principal use according to the Federal Boating Act of 1958, even though delivery be made within this state, but only when (a) the watercraft will not be used within this state for more than forty-five days and (b) an appropriate exemption certificate supported by identification ascertaining residence as provided by the tax commission and signed by the purchaser or his agent establishing the fact that the purchaser is a non-resident and that the watercraft is for use outside of this state, one copy to be filed with the tax commission with the regular report and a duplicate to be retained by the dealer.

(16) Sales of baby chicks and turkey poults for use in the production for sale of poultry or poultry products.

(17) Sales to nonresidents of this state for use outside of this state of machinery and implements for use in conducting a farming activity, when such machinery and implements will be transported immediately outside the state. As proof of exemption, an affidavit or certification in such form as the tax commission shall require shall be made for each such sale, to be retained as a business record of the seller.

(18) Sales for use in noncontiguous states, territories and possessions of the United States, but only when, as a necessary incident to the contract of sale, the seller delivers the subject matter of the sale to the purchaser or his designated agent at the usual receiving terminal of the carrier selected to transport the goods, under such circumstances that it is reasonably certain that the goods will be transported directly to a destination in such noncontiguous states, territories and possessions. . . .

* * *

RCW 82.08.050 Buyer to pay, seller to collect tax—Penalties. The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections adopted by the tax commission pursuant to the provisions of RCW 82.08.060. The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the commission, and any seller who appropriates or converts the tax collected to his own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter shall be guilty of a misdemeanor.

In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the commission in the manner prescribed by this chapter, whether such failure is the result of his own acts or the result of acts or conditions beyond his control, he

shall, nevertheless, be personally liable to the state for the amount of the tax.

The amount of tax, until paid by the buyer to the seller, or to the commission, shall constitute a debt from the buyer to the seller and any seller who fails or refuses to collect the tax as required with intent to violate the provisions of this chapter or to gain some advantage or benefit, either direct or indirect, and any buyer who refuses to pay any tax due under this chapter shall be guilty of a misdemeanor.

Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the commission, the commission may, in its discretion, proceed directly against the buyer for collection of the tax, in which case a penalty of ten percent may be added to the amount of the tax for failure of the buyer to pay the same to the seller, regardless of when the tax may be collected by the commission; and all of the provisions of chapter 82.32, including those relative to interest and penalties, shall apply in addition; and, for the sole purpose of applying the various provisions of chapter 82.32, the fifteenth day of the month following the bimonthly tax period in which the purchase was made shall be considered as the due date of the tax. . . .

RCW 82.08.060 Collection of tax — Methods and schedules. The tax commission shall have power to adopt rules and regulations prescribing methods and schedules for the collection of the tax required to be collected by the seller from the buyer under this chapter. The methods and schedules prescribed shall be

adopted so as to eliminate the collection of fractions of one cent and so as to provide that the aggregate collections of all taxes by the seller shall, insofar as practicable, equal the amount of tax imposed by this chapter. Such schedules may provide that no tax need by collected from the buyer upon sales below a stated sum and may be amended from time to time to accomplish the purposes set forth herein. . . .

* * *

RCW 82.08.040 Administration. The provisions of RCW 82.04.470 and all of the provisions of chapter 82.32 shall have full force and application with respect to taxes imposed under the provisions of this chapter. . . .

"SALE DEFINED

RCW 82.04.040 "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. It also includes the furnishing of food, drink, or meals for compensation whether consumed upon the premises or not.

"Casual or isolated sale" means a sale made by a person who is not engaged in the business of selling the type of property involved.

"SALE AT RETAIL," "RETAIL SALE" DEFINED

RCW 82.04.050 "Sale at retail" or "retail sale" means every sale of tangible personal property (including articles produced, fabricated, or imprinted) other than a sale to one who (a) purchases for the purpose of resale as tangible personal property in the regular course of business, or (8) installs, repairs, cleans, alters, imprints, improves, constructs, or decorates real or personal property of or for consumers, if such tangible personal property becomes an ingredient or component of such real or personal property, or (c) purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. The term also means every sale of tangible personal property to persons engaged in any business which is taxable under RCW 82.04.280, subsection (2), and 82.04.290.

The term "sale at retail" or "retail sale" shall include the sale or charge made for tangible personal property consumed and or for labor and services rendered in respect to the following: (a) The installing, repairing, cleaning, altering, imprinting or improving of tangible personal property of or for consumers, excluding, however, services rendered in respect to live animals, birds and insects; (b) the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above

real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include the sale of services or charges made for the clearing of land and the moving of earth, excepting the mere leveling of land used in commercial farming or agriculture; (c) the sale of or charge made for labor and services rendered in respect to the cleaning, fumigating, razing or moving of existing buildings or structures, but shall not include the charge made for janitorial services; (d) the sale of or charge made for labor and services rendered in respect to automobile towing, armored car service and similar automotive transportation services, but not in respect to those required to report and pay taxes under chapter 82.16; (e) the sale of and charge made for the furnishing of lodging and all other services by a hotel, rooming house, tourist court, motel, trailer camp, and the granting of any similar license to use real property, as distinguished from the renting or leasing of real property, and it shall be presumed that the occupancy of real property for a continuous period of one month or more constitutes a rental or lease of real property and not a mere license to use or enjoy the same.

The term shall not include the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any publicly owned street, place, road, highway, bridge, or trestle which is used for to be used primarily for foot or vehicular traffic, nor shall it include sales of feed, seed, fertilizer,

and spray materials to persons for the purposes of producing for sale any agricultural product whatsoever, including milk, eggs, wool, fur, meat, honey, or other substances obtained from animals, birds, or insects.

"SALE AT WHOLESALE," "WHOLESALE SALE" DEFINED

RCW 82.04.060 "Sale at wholesale" or "wholesale" sale" means any sale of tangible personal property which is not a sale at retail and means any charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers: *Provided*, That the the term "real or personal property" as used in this section shall not include any natural products named in RCW 82.04.100.

"GROSS PROCEEDS OF SALES" DEFINED

RCW 82.04.070 "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property and or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

"CONSUMER" DEFINED

RCW 82.04.190 "Consumer" means the following: (1) Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property other than for the purpose (a) of resale as tangible

personal property in the regular course of business or (b) of incorporating such property as an ingredient or component of real or personal property when installing, repairing, cleaning, altering, imprinting, improving, constructing, or decorating such real or personal property of or for consumers or (c) of consuming such property in producing for sale a new article of tangible personal property or a new substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale;

(2) Any person engaged in any business activity taxable under RCW 82.04.290;

(3) Any person engaged in the business of contracting for the building, repairing or improving of any publicly owned street, place, road, highway, bridge or trestle which is used or to be used primarily for foot or vehicular traffic as defined in RCW 82.04.280, in respect, however, only to tangible personal property used or consumed in such business;

(4) Any person who is an owner, lessee or has the right of possession to or an easement in real or personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business, excluding only the United States, the state, and its political subdivisions in respect to labor and services rendered to their real property which is used or held for public road purposes.

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IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1963-4

Nos. 849, 850, 851

No. 849

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*,

v.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 850

(Consolidated Appeals)

HEBB AND NARODICK, *et al.*, *Appellants*,

v.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 851

IAN MURRAY, *et al.*, *Appellants*,

v.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF WASHINGTON

MOTION TO DISMISS

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MOTION TO DISMISS

COME NOW the appellees in each of the above-entitled proceedings and respectfully move to dismiss each of the above-entitled appeals in accordance with Rule 16 of the Rules of the United States Supreme Court on the ground that these cases do not present a substantial federal question.

Introductory Comment

Each of the above-entitled proceedings involves identical facts, identical records and identical judgments.

The following motion to dismiss is therefore directed to the jurisdictional statements filed by each of the appellants in each of the above-entitled appeals.

QUESTION PRESENTED

Are corporations "federal instrumentalities" for purposes of enjoying immunity from state taxation under the following circumstances:

1. The corporations are formed by appellants (private contracting companies) as a part of the financing arrangements made by the appellants to enable the appellants to construct Capehart housing and be paid for such construction.

2. The corporations are chartered in Delaware, and qualified to do business in the State of Washington; and persons associated with the appellant-companies are the incorporators, officers and sole stockholders of the corporations.

3. The corporations lease federal lands from the United States, mortgage the leasehold interest to private financial institutions to secure the corporations' notes to such institutions in order to obtain funds from such institutions to pay for the construc-

For reasons explained hereinafter (*Infra*, page 17) no other question can possibly be said to be presented by these appeals although each of the appellants assert that these appeals also present the question of whether the retail sales herein involved are actually sales to the United States as such. (No. 849, Juris. St., p. 4; No. 850, Juris. St., p. 3; No. 851, Juris. St., p. 3.)

tion of the housing, such private sources of funds having previously been arranged for by the appellants themselves, rather than the United States.

4. The corporations enter into a housing contract with the United States and the appellants, and pursuant to this contract disburse the proceeds of the mortgage loans to the appellants to pay for the cost of construction, including appellants' profits.

5. As the housing is completed on the leased lands, the United States assumes control and assigns occupancy of the individual units of housing to families of military personnel.

6. The federal government guarantees to the private lender the repayment of the mortgage loan made to the corporations, and, after completion of construction, makes the payments on the mortgage loan by diverting the "family quarters allowances" otherwise payable to military personnel who occupy the housing.

7. The United States acquired all of the stock of the corporations when the appellants have completed construction of the housing, such stock having been placed in escrow prior to the start of construction.

COUNTERSTATEMENT OF THE CASE

Introductory Comment

Although the actual facts in each proceeding are identical, and although the cases were tried as consolidated proceedings before the trial court, and

although a single decision of the Washington State Supreme Court is involved in these appeals, the appellants have each offered a different statement of facts.

The following statement of facts is offered in order to show, as clearly and objectively as possible, and on a step-by-step basis, exactly what happens when Capehart Act housing is constructed. This should diminish the need of this Court's having to piece together, from three different statements of fact, a clear understanding of a very complicated series of transactions. This should also relieve appellees from taking individual exception to a number of irrelevancies and omissions in the three statements offered by the appellants.

In order to resolve differences in the numbering of the lower court's records in each of the above-referenced appeals, transcript references in this motion are made to the record in Cause No. 849, *Inland Empire Builders, et al. v. The State of Washington*. Appellees' transcript references are made primarily to the findings of fact which are identical in each case. (No. 849, Tr. 0018-0038; No. 850, Tr. 0024-0044; No. 851, Tr. 0051-0068.) In addition to references to the trial court's findings of fact, appellees will refer to the exhibits which are identical in each case. Since the pages of the exhibits are not numbered, but are in each case appended to the last page of the transcript of record, reference to exhibits will be made only to "Exhibit Number 1", etc.

INITIAL FINANCING ARRANGEMENTS AND ORGANIZATION OF THE MORTGAGOR-BUILDER CORPORATIONS

The first step in the procedure required for construction of Capehart housing for families of military personnel is the determination by the Secretary of Defense that there is a need for family housing in a particular area.

The Secretary of Defense made a determination of the necessity of construction of family housing in each of the localities herein involved. Thereafter, an "Advance Notice" was issued by the United States indicating that bids would soon be invited for construction of Capehart Act projects. Thereafter, an "Invitation for Bids" (Ex. 1) was issued by the United States, inviting bids from appellants and other builders for construction of Capehart housing projects which, if approved, would require the successful "builder" to take the following four "actions":

> " * * * first, to form a new corporation (hereinafter called the 'mortgagor-builder'); second, to arrange financing for total cost of the Project, including profit, by a Building Loan Agreement between the mortgagor-builder and a mortgage lender (hereinafter called the 'mortgagee'); third, to cause the mortgagee to obtain the Commissioner's Commitment for Insurance; and fourth, to execute a three-party Housing Contract which defines the rights and obligations of the Department, the eligible builder and the mortgagor-builder. * * *" (Ex. 1, IB-1). (Finding of Fact IX, Tr. 0026).

Accordingly, each of the appellants, in response to the invitation for bids for each respective project, submitted its bid to the United States (Ex. 2), which bid was accepted by a "Letter of Acceptability" (Ex. 3) from the United States.

As required by the letter of acceptability, and prior to execution of the housing contracts, leases, mortgages and other documents of the "initial closing" hereinafter described, each appellant caused the mortgagor-builder corporations to be chartered as private corporations (Ex. 4, Article Third) in the State of Delaware and to be qualified to do business in the State of Washington (Ex. 4). (Finding of Fact XI, Tr. 0026.)

As required by the letter of acceptability, sources of private capital were obtained by the appellants to finance the mortgagor-builder corporations, the loan to be secured by the mortgage of the mortgagor-builder corporations's leasehold interest (Ex. 10), FHA insurance and a guaranty of the Secretary of Defense (Ex. 16). It was understood and agreed by the appellants that the proceeds of such mortgage loans to the mortgagor-builder corporations were to be paid out by the mortgagor-builder corporations for all the costs of the entire undertaking, including payments to the appellants for the cost of construction and appellants' profit in each of the projects, and incidental costs. (Ex. 1, para. 1(e)). (cf. Finding of Fact XIV, Tr. 0028.)

As required by the letter of acceptability, a Commitment for Insurance from the Federal Hous-

ing Commissioner, insuring the loans to be extended to the mortgagor-builder corporations by the private lender, was obtained. The Commitment for Insurance was addressed to the lending institution, the mortgagor-builder corporation, and the appellants (Ex. 5). (Finding of Fact XV, Tr. 0028.)

No instrument or evidence of indebtedness was ever executed in any of these proceedings showing a direct indebtedness of the United States to the appellants (See Ex. 16, & Ex. 1, para. 1(e)). (cf. Finding of Fact XXIV, Tr. 0034.)

DESCRIPTION OF UNDERTAKINGS REQUIRED OF APPELLANTS, MORTGAGOR-BUILDER CORPORATIONS, MORTGAGEE INSTITUTIONS AND THE UNITED STATES.

In each project the appellant contractors, the respective mortgagor-builder corporations, the United States government, representatives of the Federal Housing Administration, and representatives of the lending organizations proceeded to execute various documents required by law and described in the Letter of Acceptability in a series of transactions referred to by the parties as the "initial closing" (Finding of Fact XVI, Tr. 0029).

At each of the respective "initial closings," the following documents, among others, were executed all on the same day:

1. A lease was executed by the United States, as lessor, leasing the premises upon which the respective projects were to be constructed to the

respective mortgagor-builder corporations as lessees (Ex. 6). The United States gave a receipt for the lease payment (Ex. 7).

2. Under this lease, the mortgagor-builder corporation, during the period of construction, was to maintain at its own cost and expense such insurance as was required by the Commissioner (para. 8, Ex. 6), and was obligated to indemnify the United States from any claims for damages or injuries to persons present upon the leased premises as invitees or licensees of the lessee mortgagor-builder corporation (para. 9, Ex. 6). The lessee was also obligated to save the military department harmless from laws, ordinances and regulations applicable to the leased premises with regard to construction, sanitation, licenses or permits to do business (para. 11, Ex. 6), until such time as the United States became the sole stockholder in the lessee mortgagor-builder corporation.

3. The respective appellants and the mortgagor-builder corporation for the particular project and the United States government executed a "housing contract" (Ex. 8). This contract provided, *inter alia*, that the appellants should complete the specified construction and that the mortgagor-builder corporation would pay the appellants the agreed price for completion of the contract (Art. I, para. 1(e); Art. III, para. 4, Ex. 8).

4. The mortgagor-builder corporations and the respective private lenders executed "building loan agreements" (Ex. 12), under which the private lend-

ers agreed to loan the mortgagor-builder corporation funds necessary for payment of the appellants.

5. The mortgagor-builder corporation executed a mortgage note as promisor to the private lender as promisee (Ex. 9).

6. The mortgagor-builder corporation executed a real and chattel mortgage in favor of the private lender as mortgagee (Ex. 10).

7. The officers and stockholders of the mortgagor-builder corporation executed assignments of their stock and resignations as officers to be placed in escrow pending final closing after completion of construction (Ex. 11).

8. The appellants, the respective mortgagor-builder corporations, and a corporate surety organization executed a dual obligee Federal Housing Administration payment bond by which the appellants and their corporate surety as obligors assured the "mortgagor-builder" and each respective mortgagee as obligees that the obligors would complete the "housing contract" subject to various conditions set forth therein (Ex. 13). The United States was not an obligee of the payment bonds.

9. In each transaction, the appellants and a corporate surety, as principals, executed a performance bond to the respective mortgagor-builder corporations and each respective mortgagee as obligees (Ex. 13-A). The United States was not an obligee of the performance bonds.

10. In each transaction, each respective mortgagor-builder corporation agreed to hold each respective mortgagee harmless as to real and personal property taxes on the premises during construction (Ex. 15). The payment by the mortgagor-builder corporation of its obligation under this instrument was in turn guaranteed by the United States (Ex. 17).

11. The Secretary of the particular branch of the Armed Forces at whose installation the projects were to be constructed, executed for the United States a guaranty with respect to mortgage payments (Ex. 16). The guaranty executed by the United States was to the mortgagee only. The guaranty was executed by the United States pursuant to conditions prescribed by the "Capehart Act".

12. The stock and resignations of the officers of the mortgagor-builder corporation were placed in escfow with the mortgagee, for delivery to the United States after completion of construction (Ex. 11).

PROCEDURES DURING CONSTRUCTION

In accordance with the building loan agreement (Ex. 12), the mortgagees loaned to each respective mortgagor-builder corporation the specific amount of the bid price for construction of each specific project (Ex. 9). (cf. Finding of Fact XVIII, Tr. 0031.)

During construction of each of the projects involved herein, the appellants received progress payments as portions of the work were completed. Progress payments were made to the appellants by the

mortgagee-lender on behalf of the mortgagor-builder corporation out of the loan proceeds (Ex. 8, Art. III, IV; Ex. 1, para. 1(e)). (cf. Finding of Fact XIX, Tr. 0032.) Applications for such advances from the mortgage loan proceeds were made by the mortgagor-builder corporation and the appellants on FHA Form 2403 (Ex. 25), subject to approval of the mortgagee and contracting officer (Finding of Fact XIX, Tr. 0032).

PROCEDURES AFTER CONSTRUCTION

1. As units within the projects were completed, they were made available to the appropriate branch of the Defense Department for occupancy by military personnel (Finding of Fact XX, Tr. 0033).

2. Upon completion of construction of each project a "notice of final acceptance" with respect to each project was executed by the inspecting officials of the appropriate branch of the Military; whereupon, pursuant to the provision of the housing contract, the payment of the retained percentages was made to the appellants. (Finding of Fact XXI, Tr. 0034.)

3. After final completion of the projects, the United States acquired all stock in the mortgagor-builder corporations. At the same time as the project was accepted, the entire capital stock of the mortgagor-builder corporation and the resignation of its officers previously placed in escrow were delivered to the United States under the terms and conditions of the escrow agreement (Ex. 11). (Finding of Fact XXII, Tr. 0033.)

Under the Capehart Act, the units were occupied by military personnel and their dependents, whose "quarters' allowances", or sums in lieu thereof, were paid to the mortgagees of each project to retire the mortgage loans made to each respective mortgagor-builder corporation. (See 42 U.S.C. 1594(d)(b) and Ex. 1, para. 1). These payments are made pursuant to the guaranty made by the United States to the mortgagee-lendee.

Summary of Facts

Each Capehart transaction involved four parties: (1) a contractor-builder (appellants); (2) a "mortgagor-builder corporation" (organized by the contractor-builder at the request of the United States); (3) a mortgagee (insurance company, bank or private lender which supplied private capital); and (4) the United States.

The illustration (fold-out, opposite page) is offered to assist the Court by summarizing the role of each party to each Capehart transaction involved in these proceedings.

1. CONTRACTOR (APPELLANTS) (KR)	2. MORTGAGOR-BUILDER CORPORATION (MBC)	3. MORTGAGEE-L
Submits bid		
Organizes MBC	Chartered in Delaware, qualified in Washington	
Arranges for private financing of Capehart project by Building Loan	Enters into Building Loan Agreement	Enters into Building Loan Ag bid price
	Enters into lease of realty on which Capehart project is to be built	
Receives Commitment for mortgage insurance from FHA	Receives FHA Commitment for Mortgage Insurance	Receives Commitment for mort
	Executes mortgage note to MEE	Receives mortgage note from
	Executes mortgage, securing mortgage note by mortgage on leasehold	Receives mortgage from MBC
Enters into Housing Contract with MBC and US	Enters into Housing Contract with KR and US	
		Receives from US Guaranty o
	Puts resignations of officers and corporation stock in escrow with MEE for later delivery to US	Receives resignations and stoc later delivery to US
Executes, as principal, performance and payment bonds with bonding companies as sureties	Is obligee on payment and performance bonds	Is obligee on payment and perf
Performs construction		
Receives payment as work progresses out of loan proceeds	Receives portions of loan proceeds from MEE, for payment over to KR, as work progresses	Advances to MBC portions of over to KR, as work progress
Receives final payment, in same manner as before, when project is completed	Receives final portions of loan proceeds for payment to KR	Makes final advances of loan manner as before
		Takes stock of MBC and resig escrow; delivers to US
		Receives payment on mortgag

ILDER CORPORATION (MBC)	3. MORTGAGEE-LENDER (MEE)	4. FEDERAL GOVERNMENT (US)
		Determines necessity for military housing; invites bids for construction of Capehart housing
		Issues Letter of Acceptability
qualified in Washington		
an Agreement	Enters into Building Loan Agreement to loan MBC the bid price	
y on which Capehart		Executes lease to MBC for realty on which Capehart project is to be built
ent for Mortgage Insurance	Receives Commitment for mortgage insurance from FHA	Through FHA, gives Commitment for mortgage insurance
to MEE	Receives mortgage note from MBC	
iring mortgage note by mortgage	Receives mortgage from MBC	
ntract with KR and US		Enters into Housing Contract with MBC and KR
	Receives from US Guaranty of payment of mortgage note	Executes Guaranty of payment of mortgage note to MEE
icers and corporation stock in ater delivery to US	Receives resignations and stock as escrow holder for later delivery to US	
nd performance bonds	Is obligee on payment and performance bonds	
		Inspects and supervises construction
n proceeds from MEE, for payment ogresses	Advances to MBC portions of loan proceeds, for payment over to KR, as work progresses	Approves progress payment to KR and accepts units as completed
f loan proceeds for payment to KR	Makes final advances of loan proceeds to MBC, in same manner as before	Accepts housing project and gives notice of final acceptance; approves final payments
		Through FHA, makes final endorsement of mortgage note FHA insurance takes effect
	Takes stock of MBC and resignations of officers out of escrow; delivers to US	Receives stock of MBC and resignations of MBC officers from MEE
	Receives payment on mortgage note from US	In accordance with Guaranty of payment of mortgage note, begins payment of note out of funds diverted from military quarters allowances

THE APPEALS DO NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION

I.

WHETHER OR NOT THE UNITED STATES IS THE "BUYER" IS ESSENTIALLY A QUESTION OF STATE LAW AND NOT A FEDERAL QUESTION PRESENTED BY THESE APPEALS

A. Summary of Washington Statutes

Each of the appellants has been assessed for sales taxes imposed by chapter 82.08 of the Revised Code of Washington.

RCW 82.08.020 provides in pertinent part:

> "There is levied and there shall be collected a tax on each retail sale in this state * * *" (Emphasis supplied.)

RCW 82.08.050 provides in pertinent part:

> "The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax * * *
>
> "In case any seller fails to collect the tax herein imposed * * * he shall, nevertheless, be personally liable to the state for the amount of the tax."

RCW 82.08.120 provides that the tax must be added to the sales price and cannot be absorbed by the seller.

RCW 82.08.010(1) defines "selling price" as follows:

> "'Selling price' means the consideration, whether money, credits, rights, or other prop-

erty, expressed in the terms of money, paid or delivered by a buyer to a seller, * * *"

RCW 82.04.050 defines "retail sale" as follows:

"'Sale at retail' or 'retail sale' means every sale of tangible personal property (including articles produced, fabricated or imprinted) * * *

"* * * (b) the *constructing*, repairing, decorating, or improving of *new or existing buildings or other structures under, upon, or above real property of or for consumers*, * * *" (Emphasis supplied.)

RCW 82.04.190(4) defines the term "consumer" as follows:

"Any person who is an owner, lessee or has the right of possession to or an easement in real or personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business, * * *"

RCW 82.08.010 makes applicable to the sales tax law, chapter 82.08 RCW, the definition of "consumer" quoted above.

B. Analysis of Washington Law

One of the key issues presented to the Washington State Supreme Court was the question of which party, the United States or the mortgagor-corporation, was the "buyer" under Washington law upon whom the legal burden of the sales tax fell. The appellants there argued that the United States, as such, was the "buyer", and seem to persist in that argument before this Court, at least in their statements of the questions presented. However, (with

the possible exception of Cause No. 851) none of the appellants make any further attempts to demonstrate that the question of a sale to the United States is presented. And, as we shall show, no such question can realistically be said to be presented.

In the opinion below the State Supreme Court held that, as a matter of state law, the taxable buyer, *i.e.*, the person who must pay the tax to the state, is the person who is obligated to pay the purchase price to the seller. The State Supreme Court then applied this holding to the facts of this case, and concluded that the mortgagor-corporation, and not the United States, was the buyer. This conclusion was based upon the fact that the mortgagor-corporation alone had a contractual obligation to pay the seller, for the construction, the United States being obligated by virtue of its guarantee (Ex. 15) only to make mortgage payments after the construction is completed and after the sellers had been completely paid for the construction. (See Appendix A to each Jurisdictional Statement, pp. 6-10.)

These conclusions of the State Supreme Court follow precisely the analysis made by this Court in *Alabama v. King & Boozer*, 314 U.S. 1. In that case, a private contractor, was constructing an army camp under a "cost plus" contract. The taxpayer, *King & Boozer*, furnished lumber to the contractor. Alabama contended that there was a sale of the lumber to the private contractor and not to the United States, which was by contract obligated to reimburse the contractor for the purchase price of the lumber,

including the state sales taxes. The United States, which was a party to that proceeding, conceded that the constitutional immunity of the federal government from state taxation could not be invoked merely because the economic burden of the tax was to be ultimately borne by the federal government under the reimbursement provisions of the contract. However, the United States argued that under contract provisions, whereby title to the lumber passed to the government on shipment by the seller and whereby the government made the decisions of whether to buy, what to buy and at what price, the buyer was the government itself; and that therefore, under an Alabama law which placed the legal incidence of the tax upon the buyer, the legal as well as the economic incidence of the tax was upon the government. This Court rejected the contention of the United States, stating as follows:

> "The soundness of this conclusion turns on the terms of the contract and the rights and obligations of the parties under it. The taxing statute, as the Alabama courts have held, makes the 'purchaser' liable for the tax to the seller who is required to 'add to the sales price' the amount of the tax * * * collected, [Note the exact parallel with RCW 82.08.050 and 82.08-.120 *supra*] * * * *Who*, in any particular transaction like the present, *is a 'purchaser' within the meaning of the statute, is a question of state law on which only the Supreme Court of Alabama can speak with final authority.* But it seems plain, as the Government concedes and as we assume for present purposes, that *under the provisions of the statute the purchaser of tangible goods who is subjected to the tax measured*

by the sales price is the person who orders and pays for them when the sale is for cash or who is legally obligated to pay for them if the sale is on credit. [Note also the parallel here to the decision of the Washington Supreme Court in the opinion below.] The Government's contention is that it has a constitutional immunity from state taxation on its purchases and that this was sufficiently a Government purchase to come within the asserted immunity.

"As the sale of the lumber by King and Boozer was not for cash the *precise question is whether the Government became obligated to pay for the lumber and so was the purchaser whom the statute taxes, but for the claimed immunity.* * * *" *Alabama v. King & Boozer, supra*, 314 U.S. 1, at pp. 9 and 10. (Emphasis supplied.)

Likewise, the precise question presented to the Washington State Supreme Court below was whether the federal government became obligated *to pay* the *seller* (*i.e.*, the appellant-contractors) the purchase price or selling price. And the State Supreme Court held that obviously the federal government was not so obligated, since the government's obligation to make payment extended only to the financial institution which made the loan to the mortgagor-corporation.

II.

WHETHER OR NOT THE MORTGAGOR-CORPORATIONS ARE FEDERAL INSTRUMENTALITIES IS NOT A SUBSTANTIAL FEDERAL QUESTION MERITING REVIEW BY THIS COURT

A. The Decision Below Is Clearly Correct, and Is Not in Conflict With Any Decisions of This Court

Since the sales in question were made to the mortgagor-corporations and not to the United States the question arises as to whether or not these corporations are tax exempt federal instrumentalities. Appellants each attempt to show that the decision below on this question is in conflict with certain decisions of this Court. Such attempts founder principally upon two points which all the appellants overlook, and which should be carefully noted before taking up individaully the cases cited by appellants.

The first point is one already touched upon; namely, that the mortgagor-corporations are not able to obligate the credit of the federal government, by acting as a kind of federal purchasing agent and thus obligating or spending government funds. Indeed, one of the purposes of the mortgagor-corporation is to insulate the United States from being directly obligated to pay the purchase price of the construction to the sellers; *i.e.*, the appellants, by having the mortgagor-corporation rather than the United States be the buyer obligated to pay the seller. (See Article 3, para. 4 of Exhibit 8; para. 14 of the

Housing Contract, Exhibit 8; Article 4, para. 7 of Exhibit 8; and para. 1(e) of Exhibit 1. Also see *United States ex rel. Miles Lumber Company v. Harrison & Grimshaw*, 305 F. 2d 363, and legislative history cited therein.)

The second point is this: these mortgagor-corporations were incorporated by the appellants in Delaware, were capitalized by the appellants, were qualified to do business as private corporations in Washington, and had only private parties as officers, incorporators, and stockholders. But even more importantly, these corporations were formed by the appellants *for their own purposes*; *i.e.*, as part of the financial arrangements which the *appellants themselves* made in order that the appellants might construct the Capehart housing and enjoy a profit therefrom. The appellants, and not the United States, made the necessary arrangements for obtaining a loan from a private lender to finance the construction, such arrangements including the formation of the corporation to which the loan was to be made. The United States merely set out the framework within which the financing arrangements were to be made and executed the guaranty to the lender, after all the other financing arrangements had been taken care of by the appellants themselves. And certainly every single step in these arrangements, including formation of these corporations, was taken by the appellants for their own purposes, and not merely for the purposes of the United States.

With these two points in mind, we may now

consider briefly the principal decisions of this Court cited by appellants; viz., *Clallam County v. United States*, 263 U.S. 341, (1923); (a property tax case) *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110; (a sales tax case) and *United States v. Livingston*, 179 F. Supp. 9; aff'd 364 U.S. 281, 4 L. ed. (2d) 1719 (also a sales tax case).

In *Clallam County, supra*, the corporation in question was organized by the United States, capitalized by the United States, managed by the United States, served the direct war-time purpose of only the United States, and was owned entirely by the United States, except for seven shares held by trustees for the United States. The distinction between that case and the instant case is obvious.

Kern-Limerick v. Scurlock, supra, is not helpful to appellants here because the agent or instrumentality of the federal government in that case was able to do what the mortgagor-builder corporation in the instant cases cannot do; viz., bind the federal government on a direct obligation to seller. In the *Kern-Limerick* case the federal government had apparently learned the lesson taught it by the *Alabama v. King & Boozer* decision, and had put into the sales contracts in the *Kern-Limerick* case the provision that the United States would be directly obligated to the seller. A similar provision is completely absent in the instant cases for the simple reason that the purpose of the Capehart Act is to prevent the United States from being directly obligated for the cost of construction.

The *Livingston* case is inapplicable for the same reason as in *Kern-Limerick, supra*. In the *Livingston* case the federal district court relied specifically upon this Court's decision in *Kern-Limerick*, and thus held that the United States was directly obligated to the seller. A brief review of the facts in the *Livingston* decision makes this point abundantly clear. Thus, from the facts of the *Livingston* decision it will be observed that the detailed contract between DuPont and the Atomic Energy Commission provided for a revolving fund to be deposited by the government with banks designated as depositaries of public moneys from which DuPont could draw for all of its costs and expenses, including cost of purchases by DuPont.

> "In Kern-Limerick there was a substantial question of the authority of the contracting officers to constitute the contract or with a purchasing agent of the government, but there is no such question here. This appears to be the sort of contract Congress had in contemplation in 1946 when it considered the role of American industry in the Nuclear program. * * *"
>
> "This type of contract, and the substantive relation of the parties, made it all the more appropriate that the contract require that title to all goods and materials purchased should pass directly from the vendors to the United States. DuPont's credit was not to be advanced or risked. Its disclosures in its requests for quotation and its purchase orders that the goods were being procured for the United States, to whom title would directly pass, and its imposition of the terms required of public contracts with the United States, negatived any individual liability of its own. *What obligations did arise*

from the purchase orders were discharged by drawing directly upon public funds." (Emphasis supplied.) *United States v. Livingston*, 179 F. Supp. 9 at p. 21.

The *Livingston* case is also distinguishable because the taxpayer there; viz., DuPont Company, in operating as the contractor of the Atomic Energy Commission, had as its sole and exclusive purpose the serving of the United States, without the purpose of gain to either itself or any other private party. In contrast, in the instant cases the mortgagor-corporations, during the time of construction, do not serve merely the interests of the United States, but the financial interests of the Appellants as well.

B. There Is No Disparity in Opinions of the Supreme Courts of the Several States

Appellants each suggest that this Court should note jurisdiction because of an alleged divergence between the opinions of the Supreme Court of the State of Washington in the instant cases, and those of the Supreme Court of the State of Florida and the Supreme Court of the State of Michigan, in *Green v. Elgin AFB Housing*, 104 So. (2d) 463, and *Knapp-Stiles, Inc. v. Michigan Department of Revenue*, 370 Mich. 329, 122 N.W. (2d) 642 (1962).

A divergence of opinions among the state courts would not necessarily present a substantial question. Moreover, an examination of the opinions said to be in conflict reveals that in fact there is no conflict at all.

The Washington court's majority opinion correctly distinguished both the Florida and Michigan decisions, stating they were based upon interpretations of state exemption statutes much broader than that demanded by the Federal Constitution.

In *Green v. Elgin AFB Housing*, *supra*, the Florida court specifically noted that the case involved a statutory exemption much broader than that required by the Federal Constitution, the exemption applying to sales of tangible property to contractors who, pursuant to government contract, put such property into public works.

In *Knapp-Stiles, Inc. v. Michigan*, *supra*, the Michigan court construed a similar state exemption to reach a conclusion identical to that in Florida. In *Knapp-Stiles* the exemption from the sales tax was applicable simply because the United States was a party to the housing contract.

S.S. Silberblatt, Inc. v. Tax Commission of the State of New York, 5 N. Y. (2d) 635, 159 N.E. (2d) 195, cert. den. 361 U.S. 912 (1959), is the only decision of any other state supreme court which directly determines whether a mortgagor-corporation in a Capehart transaction is to be considered a federal instrumentality. The decision of the Washington Court in these cases is completely consistent with the decision of the New York Court of Appeals. In *Silberblatt, Inc. v. New York*, *supra*, on facts directly in point with the essential facts of this case, the New York Court held that a mortgagor-builder cor-

poration is not an instrumentality of the United States. Accordingly, the New York Court refused to abate assessments of mortgage recording fees on the mortgages, identical for all intents and purposes to those involved here, which were executed by the mortgagor-corporations in anticipation of construction of Capehart housing by builder corporations situated identically to the Appellants in these cases.

The New York Court of Appeals decision is directly in point on the question of whether or not the mortgagor-builder corporation is an instrumentality of the federal government. Contrary to the several assertions of the several Appellants, no other state supreme courts other than New York and Washington, which are in accord, have ruled with respect to this question.

The New York Court of Appeals said:

> "The appellant's contention that this petitioner and the five corporate mortgagors are instrumentalities of the Federal Government or its agencies and, as such, are exempt from State and local taxation, is without substance. * * * At the time of the execution, delivery and recording of these mortgages, each of the mortgagors was a private corporation, all of the capital stock of which was privately owned. They were created for a commercial purpose for private profit, as distinguished from a governmental purpose. In the absence of statute to the contrary, it may not be assumed that a governmental function was involved. They pos-

The United States Supreme Court, despite the urgings of the Solicitor General of the United States (see 361 U.S. 802, requesting a brief from the Solicitor General, and the brief filed in response thereto), allowed the decision of the New York Supreme Court to stand. See 361 U.S. 912.

> sessed all of the requisites and responsibilities of corporate existence and, as such, are an entity separate and apart from the United States, (United States v. Strang, 254 U.S. 491 * * *) and this is so, notwithstanding the fact that all of the capital stock of each corporation will ultimately be owned by the Federal Government. (Sloan Shipyards Corp. v. United States Shipping Board Emergency Fleet Corp., 258 U. S. 549, * * *) * * *"
> *S. S. Silberblatt, Inc. v. New York*, 159 N. E. (2d) 195 at p. 198.

C. The Lower Court's Decision Is Consistent With Federal Decisions Involving Capehart Housing

It is significant that appellants have cited no federal district court or court of appeal decisions to support their contentions. For, in fact, recent federal court decisions support the Washington State Supreme Court's determination that the mortgagor-builder corporations were not federal instrumentalities when the sales were concluded. For instance, the Federal District Court in *United States v. Ft. George G. Meade, Etc.*, 186 F. Supp. 639 (1960), held the leasehold interest held by the mortgagor-corporation to be subject to the mechanics' lien law of Maryland. This could hardly follow if the mortgagor-builder corporations were truly instrumentalities of the United States. The Federal District Court stated:

> "* * * The cases cited by him (the Maryland Judge) fully support his conclusion that the so-called Capehart Act contemplates leaving the entire arrangement for the financing and construction of Capehart housing projects in the hands of private enterprise until the point

> at which the government has secured the capital stock of the Housing Corporation and that, as the land in question was leased to a private corporation, its leasehold interest is subject to the mechanics' lien law of Maryland. * * *"
> *United States v. Ft. George G. Meade, Etc.*, 186 F. Supp. 639 at p. 646.

In the *United States ex rel. Miles Lumber Co. v. Harrison and Grimshaw Construction Co.*, 305 F. (2d) 363 (1962) cert. den. December 3, 1962, 371 U.S. 920, the Federal Court held that the Capehart Act Project is not a public work for purposes of the Miller Act, 40 USCA, § 270 and § 270b. The court there observed that the eventuality that all of the stock of mortgagor-corporations will vest in the United States does not make the project a public work, or the mortgagor corporation a public corporation at the time of construction. Moreover, the court found, the fact that the mortgagee and the mortgagor, rather than the United States, are obligees on the performance bond shows the private nature of the construction. The court also noted that the Capehart Act Amendments to the National Housing Act were for the purpose of providing "the most practicable means of coping with the various serious housing problems * * * facing our military services."

> " * * * While conceding the advantages of the use of appropriated funds, Congress 'recognized that budgetary considerations would not permit the expenditure in one or two fiscal years of the sums needed,' and accordingly provided for 'the utilization of private mortgage capital to be repaid from quarters allowances

of eligible service personnel. * * * " (Citing House Report No. 2363, June 15, 1956, to accompany HR 11742, 84th Cong. 2nd Session. 3 US Code Congressional and Administrative News, 1956, pages 4509, 4546."

The court concluded,

"We are confronted here with a situation in which the project is built by a private entity with private funds at private risk. The property is encumbered by a mortgage given by a private mortgagor to a private mortgagee. Those furnishing labor and materials during project construction may assert liens under state law against the property. The eventuality that title will vest in the United States does not make the project a public work. * * * " *United States ex rel. Miles Lumber Co. v. Harrison Grimshaw*, 305 F. (2d) 363 at pp. 365, 366.

D. The Question of Whether Or Not the Mortgagor-Corporations Are Federal Instrumentalities Is Not Substantial As a Matter of Public Importance

It is significant that the issue of whether or not the mortgagor-corporations under the Capehart Act are federal instrumentalities for purposes of exemption from state taxation has been raised and squarely ruled upon only in two decisions: this decision of the Washington State Supreme Court, and the decision of the New York Court of Appeals in *Silberblatt, Inc. v. New York*, 5 N.Y. (2d) 635, 159 N.E. (2d) 195, cert. den. 361 U.S. 912 (1959). Thus, since the beginning of the Capehart program approximately eight years ago, the issue seems to have been of no widespread importance.

One possible reason for this fact may be that in very few cases would there be any likelihood of a

tax falling directly upon the mortgagor-corporation. The New York mortgage-recording tax involved in *Silberblatt* is one such instance, but apparently few, if any, other states in which Capehart Housing has been constructed have a similar tax. The Washington State sales tax is another such instance, but appellees have found no other state which has the two factors in its sales tax law which result in the tax being imposed upon the mortgagor-corporation. These two factors are, of course, the fact that in Washington the tax is imposed upon the purchaser, and the additional fact that construction itself is defined as a retail sale. Absent either factor, the lawsuits giving rise to these appeals would never have taken place.

In short, it seems most unlikely that the issue of the nature of the mortgagor-corporation will be of any more widespread significance in the future than it has been in the past.

CONCLUSION

For the reasons given above, appellees respectfully submit that each of these appeals should be dismissed for want of a substantial federal question.

Respectfully, submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1963-4

No. 849

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 850

(Consolidated Appeals)

HEBB AND NARODICK, *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 851

IAN MURRAY, *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

APPELLANTS' CONSOLIDATED BRIEF IN OPPOSITION TO APPELLEES' MOTION TO DISMISS

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OTHER AUTHORITIES

105 Cong. Rec. (Daily Ed., May 18, 1959) A 4156, 4157 13

Senate Report 231, 85th Cong. 1st Sess. 13

In the
Supreme Court of the United States

OCTOBER TERM, 1963-4

No. 849

INLAND EMPIRE BUILDERS, INC., *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 850

(Consolidated Appeals)

HEBB AND NARODICK, *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

No. 851

IAN MURRAY, *et al.*, *Appellants*,

vs.

THE STATE OF WASHINGTON, *et al.*, *Appellees*.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

APPELLANTS' CONSOLIDATED BRIEF IN OPPOSITION TO APPELLEES' MOTION TO DISMISS

I.

COMMENTS ON APPELLEES' COUNTER-STATEMENT OF THE CASE

It is not intended in this brief to analyze factual questions in the detail appropriate for a full hearing. However, if certain unarguable facts about Capehart construction are kept in mind, the so-called "very complicated series of transactions" becomes quite simple. In their Counter-Statement of the Case, appellees extract a provision or a sentence from certain of the documents that the United States required to be executed

in these cases and fail to mention other provisions from the same documents that are pertinent to the questions presented by these appeals. In any event, it is the position of the appellants that all of the documents that are exhibits in this case must be treated and interpreted as a whole, as expressed by the dissent of the Washington Supreme Court:

> "Under the established rule for the construction of contracts, a contract must be picked up by its four corners and considered in its entirety. In so doing, it is inescapable to conclude other than that the prime purpose of the housing contract was the construction of military housing for the exclusive use of the United States. (Opinion of the Supreme Court of the State of Washington, Appendix A, pp. 17 and 18 to Jurisdictional Statements)

It is true, as stated on page 10 of appellee's Motion to Dismiss, the Military Departments left it up to the bidding contractors to obtain a commitment for the construction loan to finance the military housing, but it is a pure fiction to contend that the loans were made to the Capehart corporations or that they were secured by a mortgage on a leasehold granted by the United States to the Capehart corporations. The loan was made to the United States based upon the following undertakings of the United States in the Housing Contract:

> "Article XVI PAYMENT OF THE MORTGAGE NOTE
> (29) The Department shall to the extent that advances made against the mortgage note (identified in the Building Loan Agreement above referred to) have been approved by the Commissioner, make payments in accordance with the terms of said note, provided that this obligation to make payments

> shall not become effective until the Commissioner shall have finally endorsed said note for mortgage insurance, or upon the complete termination of the Housing Contract for the convenience of the Department prior to completion of the project." (Exhibit 8, page 8)

At the time of executing the Housing Contract, the United States also executes what is referred to as a Guaranty Agreement but what is in fact a direct agreement to repay the construction loan, as appears from the following provision thereof:

> "2. The Department will, subject to the conditions stated in the foregoing guarantee *(sic)* make each periodic payment becoming due to the mortgagee on said note in accordance with the terms thereof without any requirement that the mortgagee shall have made a prior demand to the mortgagor-builder for such payment." (Exhibit 16, page 1)

The lease agreement has *no right of possession or other benefit*, and therefore a mortgage on such a lease is without security. The lease, the note, the mortgage, and the creation of a corporation to serve as a straw man in executing these documents was solely a device to legally qualify this type of loan to the United States for the lending institutions involved. This function is described in the opinion of William P. Rogers, United States Attorney General, of October 22, 1959, at page A-7 of Appendix to Appellants' Brief, Tr. 0068:

> "*First*. The duplication of insurance by the Commissioner and guaranty by the Secretary is based on the consideration that, while, basically, Armed Services Housing constitutes a responsibility of the Department of Defense, mortgages in-

sured by the Federal Housing Administration can be financed relatively easily because virtually all states have legislation making them legal investments for banks and similar institutions. The enactment of state legislation making mortgages insured by the Federal Housing Administration can ments throughout the nation, and thus generally financially acceptable to institutional investors, probably would have taken five years, to judge from past experiences. In these circumstances it appeared desirable that Armed Services Housing mortgages should carry the customary insurance by the Federal Housing Commissioner as well as a guaranty by the Secretary of Defense."

The contractor, as part of his construction costs, paid $1,000.00 to the corporation for purchase of its stock, which $1,000.00 was immediately paid to the United States as rental under the illusory lease. The corporation then is a shell, having neither funds, a beneficial interest in the lease nor any possibility of benefit from any portion of the transaction. It is prohibited by the contract documents from making a profit.

Although the stock is issued in the name of the contractor, such contractor is deprived of all incidents of ownership prior to any construction when, pursuant to the contract document requirements, he endorses the stock in blank and places it in irrevocable escrow for delivery to the United States under any contingency. The escrow agreement provides for disposition of the stock as follows:

"Delivery by the depository to the Department (I) upon receipt of written notice from the Federal Housing Commissioner that he has issued the Determination of Completion . . . or (II) upon

> written notice . . . that said Housing Contract has been completely terminated for the convenience of the Department, whichever event first occurs." (Exhibit 11, page 2)

There is no condition under which such stock ever could revert to the contractors.

In Paragraph 11, page 14, appellees state that the guaranty executed by the United States was to the mortgagee only. In fact, the agreement to repay the construction loan was made directly by the United States with the contractor in the construction contract, as above quoted, and this agreement by the United States supplied the sole consideration upon which the entire transaction rested.

With reference to payments to the contractor from the mortgage proceeds, it is particularly significant that although such applications are nominally processed by the Capehart corporation, the only approval required is that of the Contracting Officer on behalf of the United States, the lending institution and the FHA Commissioner. The following is quoted from the Housing Contract:

> "(7) * * * * The sum to which the eligible builder shall be entitled upon any such payment shall be the total of the purchase price . . . of uninstalled acceptable materials suitably stored on the mortgage property in a manner *acceptable to the Contracting Officer*, plus the cost of the portions of the work acceptably completed, *as approved by the Contracting Officer*, computed in accordance with . . ." (emphasis supplied) (Exhibit 8, p. 3)

The contract further provides:

> "Paragraph 14 — PAYMENTS TO ELIGIBLE BUILDER
>
> "a. The eligible builder shall submit to the Contracting Officer his application for each payment on FHA form 2448 and as agent for the mortgagor-builder, shall submit to the Contracting Officer FHA form 2403 . . .
>
> "b. When the eligible builder has made proper application for payment as provided for in this Housing Contract, the Contracting Officer shall promptly process such application within a reasonable time, giving the eligible builder notice of action taken by the Contracting Officer on each such application of the eligible builder.
>
> "c. *The title to all material and work covered by progress payments made shall thereupon vest in the Department,* . . . (emphasis supplied) (Exhibit 8, p. 18)

Likewise on page 12 of their Motion to Dismiss, appellees specify only a few provisions of the Housing Contract (Ex. 8). No mention is made by appellees of the fact that the Housing Contract contains all of the normal provisions required of public contracts with the United States, including the "officials not to benefit" provision, the Buy American Act, the Convict Labor provision, the non-discrimination in employment provision, the eight-hour law provision, the labor and apprentice provision, the Copeland (anti-kickback) Act provision, the utilization of small business concerns provisions and provisions subjecting the contractor to renegotiation as required by Section 104 of the Renegotiation Act of 1951 (Ex. 8, pp. 20 through

27). Article XIV, paragraphs 22 and 23, provide that each housing unit is to be placed under the control of the United States upon determination by the Contracting Officer and the Commissioner that each such unit is available for occupancy. Article XX, paragraph 34, provides that all items that remain personal property acquired or manufactured by appellants shall be deemed to be acquired for resale or manufactured for sale to the United States.

On page 16 of Appellees' Brief and the fold-out attached, they attempt to raise an inference that the private funds of occupying military personnel are used to make the mortgage payments, from which it would presumably be argued that public funds are not actually involved. We quote from the statute involved, which should dispel any such inference:

> "42 USC 1594d, 69 Stat. 653—Appropriations; use of quarters allowances
>
> "(a) There are authorized to be appropriated such sums as may be necessary to carry out the provisions of Sections 1594-1594c of this title.
>
> "(b) Any funds heretofore or hereafter authorized to be expended by any of the military departments or the Coast Guard for the payment of allowances for quarters for military personnel may be used for the purposes specified in subsection (a) of this section. Aug. 11, 1955, c. 783, Title IV, Sec. 407, 69 Stat 653."

Obviously, the loans have to be repaid whether the housing is occupied or not. If occupied, the occupants are not entitled to a quarters allowance because the government is supplying them quarters, and the funds

otherwise allocated to quarters allowance *may be* used to pay the mortgage loan. In any event, the loan payments must be made directly by the United States from its own funds.

In essence, then, the United States borrows funds from private lenders to construct military housing, and uses a straw man corporation, a lease and mortgage which are nominal only, insured by the Federal Housing Administration, for the sole purpose of enabling the lenders to legally make the loan. The entire transaction is completely controlled to the last detail by the United States, and only the United States, through the contract documents and the authority of the contracing officer representing the Military Department involved.

II.

WHETHER OR NOT THE UNITED STATES IS THE "BUYER" IS A FEDERAL CONSTITUTIONAL QUESTION

Appellees contend that the question involved as to whether the United States is the "Buyer" of the military housing constructed by appellants is essentially a question of state law and not a federal question. The argument appellees advance in support of this contention, however, goes basically to the merits of the question and not to its characterization as either a state or a federal question. The argument of appellees is in substance that the Washington Supreme Court was clearly correct in deciding that the United States was not the "buyer" and conclude that therefore no federal question is presented.

It is not our purpose here to argue the merits of the question as appellees have done, but to demonstrate that a federal constitutional issue of substantial importance exists and that it is incumbent upon this Court to determine for itself the facts and constructions upon which it rests.

Both appellees and the Washington Supreme Court reached the conclusion that the United States is not the "buyer" of the military housing constructed by appellants by attempting to force these cases into the mold of *Alabama v. King & Boozer*, 314 U.S. 1, 86 L.ed. 3, 62 S.Ct. 43 (1941). In its opinion the Washington court stated:

> "We must therefore determine who is the buyer under the facts of the instant case. In this regard, appellants contend that the United States is the buyer because it bears the economic burden of paying for the military housing, by virtue of its guarantee of a mortgage obligation." (Opinion of the Supreme Court of the State of Washington, Appendix A, page 8 to Jurisdictional Statements)

The state court in effect answered the question presented by appellants by phrasing it in this manner so that the ruling of *King & Boozer* would be clearly applicable. Appellants do not dispute that *King & Boozer* stands for the proposition that the fact that the economic burden of a state tax may be borne by the United States does not render the tax thereby invalid.

But appellants have never and do not now contend that the United States is the "buyer" *merely because it bears the economic burden of the taxes in question*. Appellants' position as to the merits of the question is

that a proper determination and construction of all of the facts and exhibits in these cases will result in a finding that the United States is the "buyer" and that the mortgagor-builder corporations are not, for the United States *alone* determines the need for the military housing, prepares the plans, issues bids for the work, contracts with the acceptable bidder by accepting his bid, pledges its credit and agrees to pay the mortgage loan so that private mortgage money can be obtained during the construction period, takes title to the housing units as progress payments are made, takes possession of the housing units as they are available for occupancy and exclusively uses the same, and pays the promissory note of the private lender in accordance with its terms without any prior demand.

In an attempt to characterize this question as a question of state law, appellees quote certain language from *King & Boozer* on pages 20 and 21 of their Motion to Dismiss. In part, that quotation read: "Who, in any particular transaction like the present, is a 'purchaser' within the meaning of the statute, is a question of state law on which only the Supreme Court of Alabama can speak with final authority." Appellants have already shown in their Jurisdictional Statement that this precise language was explained and clarified by this Court in the subsequent case of *Kern & Limerick, Inc. v. Scurlock*, 347 U.S. 110, 98 L.ed. 546, 74 S.Ct. 403 (1954) as follows at page 121 of U.S.:

> "Read literally, one might conclude this Court was saying that a state court might interpret its tax statute so as to throw tax liability where it shows, even though it arbitrarily eliminated an ex-

> empt sovereign. Such a conclusion as to the meaning of the quoted words would deny the long course of judicial construction which establishes as a principle that the duty rests on this Court to decide for itself facts or constructions upon which federal constitutional issues rest. The quotation refers, we think, only to the power of the state court to determine who is responsible under its law for payment to the state of the exaction."

In that case the determination by the Arkansas Supreme Court that the United States was not the purchaser was reversed by this Court. Appellees continue to rely upon the language quoted above from *King & Boozer* and ignore that explanation and clarification made of that language by this Court in the *Kern-Limerick* case. While the language quoted by appellees from *King & Boozer* does not support their assertion that only a question of state law is involved, the decision in *Kern & Limerick* by this Court does support appellants' position that a federal constitutional issue exists and that it is for this Court to determine under all of the facts of these cases whether the United States is the "buyer" of the military housing constructed by appellants.

The Washington Supreme Court determined as a question of state law that the "buyer" and not the "consumer" is the person responsible under the Washington sales tax statute for payment of the sales tax (Opinion of the Washington Supreme Court, Appendix A, pages 7 and 8). Appellants do not dispute that the Washington Supreme Court has the exclusive authority to determine such a question, but it cannot speak with final authority on the question of who is the

"buyer" where the United States is involved, for the decision in *Kern & Limerick* established that the ultimate determination of such a question is for this Court.

In the present case, this Court could find that the transaction occurred in three forms, any one of which would result in the application of sovereign immunity. Either the United States was the direct purchaser, or it purchased through the Capehart corporation, acting as a federal agent, or the Capehart corporation made its purchase in the status of a federal instrumentality. Each of these interpretations could arise from the application of the cases and arguments presented in the jurisdictional statements of the appellants as well as in this reply brief.

III.

THE PROTECTION OF THE SOVEREIGN IMMUNITY OF FEDERAL INSTRUMENTALITIES ALWAYS PRESENTS A SUBSTANTIAL FEDERAL QUESTION

On page 22, appellees argue that there can be no bona fide claim that the Capehart corporations are federal instrumentalities because:

1. They are not able to obligate the credit of the federal government.

2. The appellants formed the Capehart corporations for their own purposes.

Even if these conditions were true, they would not be fatal to entitlement to sovereign immunity in the circumstances of this case. However, neither of the contentions is supportable.

With reference to assertion 1, the simplest answer is that the credit of the United States is already fully and unconditionally obligated, subject only to the contractor's faithful performance of its obligations as in the case of any other government purchase contract. The obligation first arises upon the issuance by the United States of the acceptance of the contractor's bid (long before the Capehart corporation is formed) and is renewed in the Housing Contract itself. As previously stated, at the time of executing the Housing Contract, and in performance of its repayment obligation set forth in that contract, the United Sates issues to the lending institution its "guaranty." This "guaranty" has been described in a Senate Report quoted in the October 22, 1959 Opinion of William P. Rogers, United States Attorney General, as follows:

> "S. Rept. 231, 85th Cong., 1st sess.
>
> "'. . . a mortgage as secure as a United States Government bond in practically every respect. This security is based on the fact that the Secretary of the respective service gives the lender an unconditional written guaranty of all mortgage payments. With this guaranty by the Federal Government, acting through the Secretary of the Air Force, Army, or Navy, as the case may be, the FHA insurance of the mortgagee becomes unimportant. This guaranty by the Government places the credit of the United States behind these mortgages.'"[1] (Appendix p. A-16 to Appellant's Brief, Tr. 0068)

[1] See also the extension of remarks of Representative Collier (105 Cong. Rec. (Daily Ed., May 13, 1959), A4156, 4157) pointing out that the repayment of the mortgage "is unqualifiedly and absolutely guaranteed by the U.S. Government," and that a guaranteed mortgage constitutes a "truly direct obligation" of the United States.

Appellees find themselves in an anomalous position. They contend that the Capehart corporation is purchasing the housing from the contractor, and that it is the Capehart corporation that disburses the mortgage proceeds to the contractor in payment for work performed. These payments can be made only upon approval of the mortgagee, the Contracting Officer and the FHA Commissioner under Article IV of the Housing Contract, upon which event the United States becomes obligated to repay such advances, under the guaranty agreement and Article XVI of the contract. Even under appellees' theory, then, the Capehart corporation makes the advances which the United States immediately becomes obligated to repay. How more clearly could the credit of the United States be obligated.

The second point made by appellees is even less sustainable; that the appellants formed the mortgagor-builder corporations for their own purposes. Appellees have apparently abandoned the position they took before the Washington Supreme Court to the effect that the mortgagor-builder corporations had purposes of their own. In its decision, the Washington Supreme Court implied that the mortgagor-builder corporations did have purposes of their own as well as those of the United States (Opinion of the Supreme Court of the State of Washington, Appendix A, page 12; cf. the dissent, Appendix A, pages 23 and 24). If there is anything clear in the facts of these cases, it is that the United States conceived the entire financing arrangement for Capehart Act military housing and required appellants by contract to comply with the scheme in every detail, including the formation of the mortgagor

builder corporations and their sole purpose and function was expended and completed upon execution of the various documents required by the United States to accommodate the financing methods determined by the United States. The United States even supplied forms of the Articles of Incorporation and the By-Laws of the mortgagor-builder corporations. Appellant had no more interest or use for the mortgagor-builder corporations than they had for the military housing units they constructed. It would hardly be argued that the military housing was private housing because the contractor hoped to make a profit in constructing it for the United States.

The purpose of the mortgagor-builder corporations is a completely federal one and the benefits derived from the utilization of financing agents of this type extend to the public and not to the appellants.

Appellees have advanced their argument in an attempt to bring the mortgagor-builder corporations within the distinction made by Justice Holmes in *Clallam County v. United States*, 263 U.S. 341, 68 L.ed. 328, 44 S.Ct. 121 (1923), where, in sustaining the status of a private corporation as a federal instrumentality, it was stated at page 345 of U.S.:

> "This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account. The incorporation and formal erection of a new personality was only for the convenience of the United States to carry out its ends."

The conclusion of the dissenting opinion in the decision of the Washington Supreme Court in these cases with

regard to the status of the mortgagor-builder corporations is correct:

> ". . . it [the mortgagor-builder corporation] was nothing more than an instrumentality of the United States government; that it had no commercial purpose other than for the convenience of the United States, serving as a means to the end of obtaining this military housing; and that the sovereign immunity of the federal government applies." (Opinion of the Supreme Court of the State of Washington, Appendix A, page 24, Jurisdictional Statements).

The only difference between these cases and the *Kern & Limerick* case and that of the *United States v. Livingstone*, 179 F.Supp. 9; affd. *per curiam* 364 U.S. 281, 4 L.ed.(2d) 1719, 80 S.Ct. 1611 (1960) is that in these cases the United States is obligated to repay the lending institution rather than the purchasing agent, but the obligation of government funds is identical in all three cases and title vested immediately in the United States in all three cases.

IV.

THE UNITED STATES WAS NEVER DIRECTLY OBLIGATED TO THE VENDORS IN THE *LIVINGSTONE* CASE

On page 25 of their Motion to Dismiss, appellees seek to distinguish the *Livingstone* case by asserting that in that case the United States was directly obligated to the seller. The case involved the application of the South Carolina sales and use taxes to purchases made by DuPont in the operation of the Savannah River project for the Atomic Energy Commission. The same

question was involved in that case as here for the court stated:

> "* * * Here the sole question is whether or not the United States is the real purchaser and user of the purchased articles so as to make their purchase and use immune from state taxation. That question arises under the Constitution of the United States and its answer is not dependent upon the resolution of any question of state law. * * * " (179 F. Supp. 9 at page 12)

But there is nothing in the *Livingstone* case to indicate that the United States was ever directly obligated to any seller. DuPont was authorized to make purchases under the terms of its contract with the United States and it was to be reimbursed for all of its costs and expenses, for the purpose of which the contract provided for a revolving fund to be deposited by the United States with certain banks. DuPont was authorized to draw against such funds in payment of purchases and expenses.

No one can dispute that DuPont is a private corporation, privately owned, and having purposes of its own. Yet, under the contract in the *Livingstone* case, the court concluded that it was merely acting as an agent for the United States in its procurement activities, despite the fact that the contract did not designate it specifically as an "agent" for this purpose.

In the quotation from the *Livingstone* case set forth by the appellees on page 25 of their Motion, the following sentence appears:

> "This type of contract, and the substantive relation of the parties, made it all the more appropriate

> that the contract required that title to all goods and materials purchased should pass directly from the vendors to the United States."

As we have previously indicated, the Housing Contract in these cases provided:

> "(c) The title to all material and work covered by progress payments made shall thereupon vest in the Department. . . ." (Exhibit 8, page 18)

The *Livingstone* case noted:

> "DuPont's credit was not to be advanced or risked."

In the present case, the Capehart corporation has no credit which could be advanced or risked. The successful completion of the construction was assured by performance and payment bonds, the surety on which were subject to approval of the United States, and the construction was performed on the contractual commitment of the United States to repay the construction costs.

Again from the *Livingstone* case at page 21:

> "Its disclosures in its requests for quotation in its purchase orders that the goods were being procured for the United States, to whom title would directly pass, and its imposition of the terms required of public contracts with the United States, negatived any individual liability of its own."

In the present case, the fact that the housing is for the United States permeates the entire transaction. Unlike the DuPont purchases which could be made in amounts under $10,000 without even approval of the Atomic Energy Commission, the United States in this case was a party to the actual purchase agreement with

the contractor. As previously pointed out, the present contract also contained all of the provisions required of public contracts with the United States.

Appellees argue that the construction funds paid over to the contractor in the present case are not public funds. We assert that funds borrowed exclusively in reliance on the credit of the United States can never be anything but public funds, usable only for public purposes.

Finally, appellees urge that DuPont Company had as its sole and exclusive purpose the serving of the United States whereas the Capehart corporations were serving the contractor as well. We have previously commented on what we deemed to be the illogic of this contention and further suggest that in terms of national prestige and good will, DuPont was accomplishing an individual business purpose. However, the so-called benefits or purposes in either case, even if found to exist, are much too incidental to destroy the status of each entity as an agent of the United States.

V.

THERE IS A FUNDAMENTAL CONFLICT IN THE OPINIONS OF THE SUPREME COURTS OF THE SEVERAL STATES CONCERNING THE CAPEHART ACT HOUSING

On pages 26 to 29 of their Motion to Dismiss, appellees contend that the cases cited by appellants in their Jurisdictional Statement are distinguishable because they involve the application of state sales statutes different from the Washington statute. In the Jurisdictional Statement submitted by appellants, its is pointed

out why the decisions in *Green v. Kaiin AFB Housing, Inc.*, 104 So.(2d) 463, and *Knapp-Stiles, Inc. v. Michigan Department of Revenue*, 370 Mich. 329, 122 N.W. (2d) 642 (1962), striking down the application of state sales tax statutes to Capehart Act construction are here applicable. Those Jurisdictional Statements also point out why the majority decision in the case of *Silberblatt, Inc. v. Tax Commission of the State of New York*, 5 N.Y.(2d) 635, 159 N.E.(2d) 195, regarding the status of the mortgagor-builder corporations, is in error. In that majority decision, the New York Court of Appeals said:

> "They were created for a commercial purpose for private profit, as distinguished from a governmental purpose." (159 N.E.(2d) 195 at page 198)

Appellants have shown that the mortgagor-builder corporations were required by the United States, that they had no commercial purpose but were formed solely to perform the financing function desired by the United States, and that they were expressly prohibited from making any profit whatsoever. The dissenting opinion in the *Silberblatt* case was correct, just as the dissenting opinion in these cases stated:

> "An analysis of *In re S. S. Silberblatt, Inc. v. Tax Comm. of the State of New York*, 5 N.Y. (2d) 635, 159 N.E.(2d) 195, 186 N.Y.S.(2d) 646 (1959), cited by the majority, discloses that the opinion is based on the erroneous premise that the Delaware corporations were '. . . created for a commercial purpose for private profit, as distinguished from a governmental purpose.' As heretofore stated, consideration of the housing contract in its entirety cannot support such a conclusion.

The analysis of the housing contract and the reasoning of the dissent in the *Silberblatt* case is correct." (Opinion of the Supreme Court of the State of Washington, Appendix A, page 22, Jurisdictional Statements).

VI.

THERE IS AN IRRECONCILABLE CONFLICT IN FEDERAL COURT DECISIONS INVOLVING CAPEHART HOUSING

On page 29, appellees state that recent Federal Court decisions support the majority decision below and cite only two of the at least five Federal District and Circuit Court decisions relating to Capehart housing, all of which involve proceedings related to the payment bond of the contractor.

We shall cite three federal cases which are in direct conflict with the cases cited by appellees. Appellants have not felt that any of these cases were sufficiently relevant to be of assistance in determining the present issues, but in total they support the position of the appellants herein with the possible exception of *United States v. Harrison & Grimshaw Construction Co.*, 305 F.(2d) 363, which is demonstratively in error.

In *Autre v. Williams and Dunlap*, 185 F.Supp. 802, 1960—D.C., W.D. La., the court held that the Miller Act and the Capehart Housing Act were harmonious and "that the congressional intent was and is that only one bond be required for construction of a public building as contracted" for purposes of vesting federal jurisdiction.

In *Lasley v. United States*, 285 F.(2d) 98, 1960—

C.A. 5, the court of appeals referred to the bonding provisions of the Capehart Act, to-wit:

42 U.S.C.A. Sec. 1594 Subsection (a)

"* * * Any such contract shall provide for the furnishing by the contractor of a performance bond and a payment bond with a surety or sureties satisfactory to the Secretary of Defense, or his designee, and *the furnishing of such bonds shall be deemed a sufficient compliance with the provisions of section 270a of Title 40*, and no additional bonds shall be required under such section * * *" (Emphasis added)

Title 40, U.S.C. Sec. 270a is, of course, the Miller Act. The appellant in that case argued that since the bonds in controversy were not executed pursuant to the Miller Act and since a similar jurisdictional provision is not contained in the Capehart Act, the District Court did not have jurisdiction. The court held at page 100:

"We think it clear that Congress considered that but for the provisions of the Capehart Act, quoted above, a contractor would be required to supply a builder with a Miller Act bond before entering upon a Capehart construction job, because such a project falls within the language 'construction . . . of any public building or public work of the United States;'"

In *United States v. Ft. George G. Meade*, 186 F.Supp. 639, (1960—D.C. Md., the court also refers to the quoted statutory language and concludes at 645;

"This language, although indicating that Capehart Housing Projects would otherwise come within the provisions of the Miller Act, by providing

that a payment bond furnished pursuant to section 1594(a) constitutes 'a sufficient compliance' with the provisions of the Miller Act . . ."

and then determines that the quoted provision supersedes the Miller Act as to Capehart Housing. The court finally concludes, consistent with the above-cited opinions, that the provisions of Section 1594(a) of Title 42 requiring the furnishing of a Capehart payment bond and providing it shall be deemed a sufficient compliance with the provisions of Section 270a of the Miller Act incorporate by reference the provisions of Section 270b of the Miller Act, permitting suit in Federal court. The court particularly states in effect that if there is a lienable interest, such interest does not render "the housing project in question something other than a public work."

In *Robertson Lumber Company v. Progressive Contractors*, 196 F.Supp. 171 (1961—D.C. N.D.), the court followed the above decisions in holding that a Capehart corporation was a public project and the court therefore had jurisdiction under the Miller Act.

Appellants certainly do not want to be diverted to an argument on the issues involved in these cases, but cite them only in contravention to appellees' assertion that they support a characterization of the Capehart project as a private enterprise. Note that in *United States v. Ft. George G. Meade*, where the court cites an unreported decision as authority for the possible existence of a lienable interest, it further observes that the court also observes "the government, by such sale could not be deprived of its paramount right to the use and control of the property" for the obvious reason

that the Capehart corporation has nothing which could be sold. The court later observes that such a lien "is of importance only as a means of leverage to force payment to a supplier . . ."

United States v. Harrison & Grimshaw Construction Co., 305 F.(2d) 363 (1962), C.A.-10, has come to an incorrect decision because it has misconstrued the facts. It carefully cites the case of *Armstrong v. United States*, 364 U.S. 40, 80 S.Ct. 1563, 4 L.ed.(2d) 1554, as stated:

> Page 42 of U.S.
>
> "The sovereign's immunity against materialmen's liens has never been extended beyond property actually owned by it."

but it overlooked the crucial observation in that case, to-wit:

> "While the Government was obliged to make progress payments based on the percentage of the work completed, nothing in the contract provided that ownership of the portion of the work paid for should vest in the United States. On the contrary, it was stipulated that all progress payments should be secured by a paramount government lien on the property."

We can only assume that the provision of the construction contract heretofore quoted in this brief as vesting title in all construction and even in material delivered to the site in the United States was not pointed out to the court in the *Harrison & Grimshaw* case. Had the court of appeals observed this provision, it presumably would have come to an opposite result from the very rationale and observation of the *Armstrong* case upon which it relies.

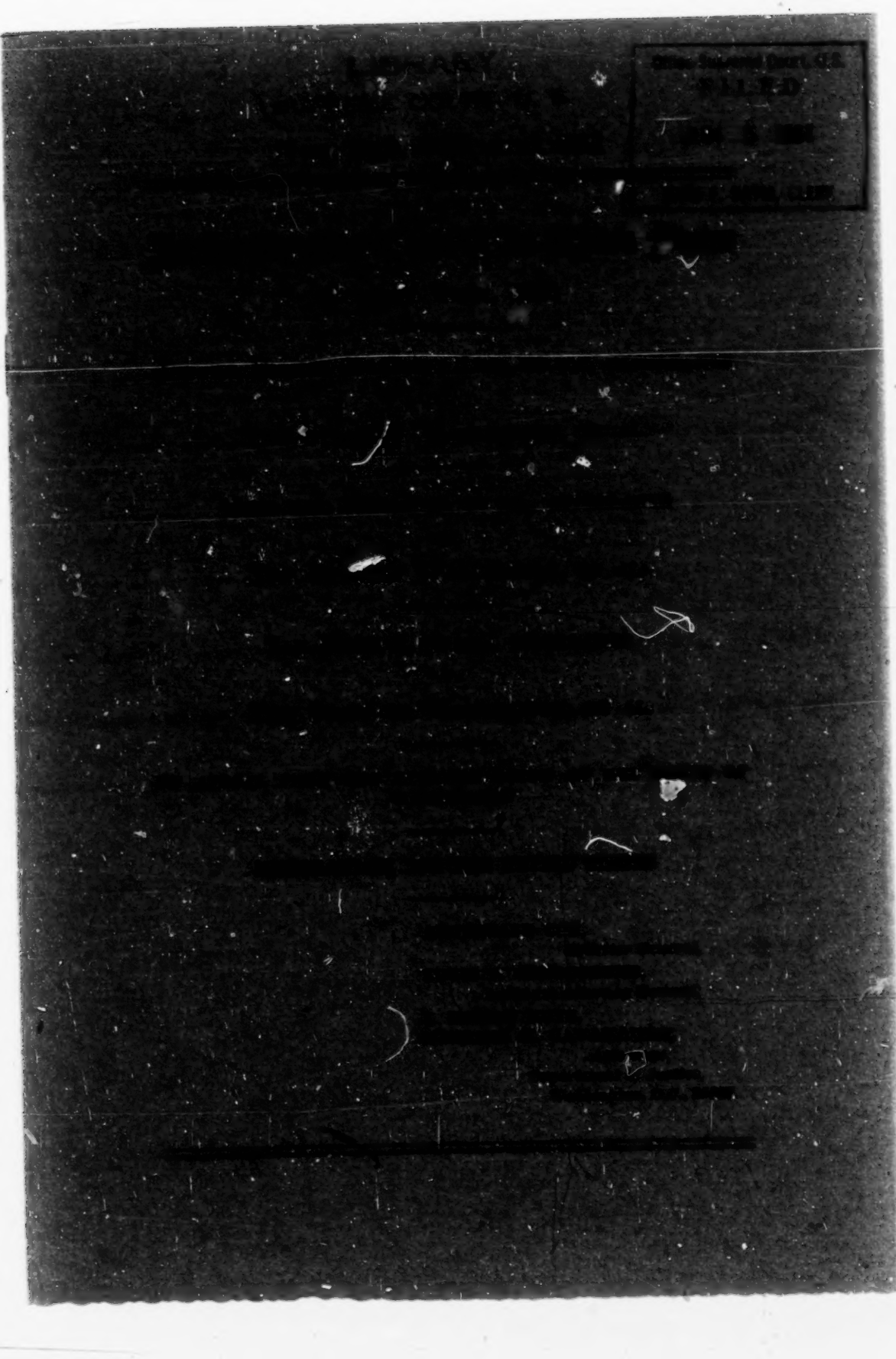
It can be seen that the confusion in the foregoing cases renders them of slight assistance in the present controversy, but if anything, the surmounting proposition is that Capehart construction is part of the public works of the United States, a fact which the mere reading of the contract establishes beyond dispute.

VII.

THE CONTINUED EXISTENCE OF SOVEREIGN IMMUNITY FOR FEDERAL INSTRUMENTALITIES PRESENTS AN ISSUE OF FUNDAMENTAL IMPORTANCE

Contrary to the assertion of appellees on pages 31 and 32 of their brief, four state supreme court opinions involving questions of tax liability arising out of Capehart construction have considered the status of Capehart corporations as federal agents or instrumentalities of sufficient importance to such decisions to warrant extensive analyses of the issue. The conflict in application between the *Eglin AFB Housing* and the *Knapp-Stiles* cases on the one hand, and the *Silberblatt* and present case on the other, demonstrates the uncertainty which attends the application of this doctrine.

The importance and significance of the present case does not arise solely from the amount of tax liability involved or from its impact on present or future Capehart type situations. The importance and significance of this case is that unless it is reversed, the doctrine of sovereign immunity of federal instrumentalities, as announced in *McCulloch v. Maryland*, 4 Wheat. 316, 17 U.S. 159, defined in *Clallam County v. United States*,



In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 849

INLAND EMPIRE BUILDERS, INC., ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

No. 850

HEBB AND NARODICK, ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

No. 851

IAN MURRAY, ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

MEMORANDUM FOR THE UNITED STATES

This memorandum is filed in response to the order of this Court, dated May 4, 1964, inviting the Solicitor General to express the views of the United States.

733-387—64

1. In order to provide government-owned military housing as expeditiously as possible and without including the full costs of construction in the current budget, in 1955 Congress passed the Capehart Act (69 Stat. 646, *et. seq.*), authorizing a method of financing military housing through private lending facilities. See S. Rep. No. 231, 85th Cong., 1st Sess., p. 26, *et. seq.* The heart of the system is simple and involves only three parties: the United States, the contractor, and the lending institution which finances the construction. The contractor is paid an amount agreed upon with the government for building to the government's specifications. This amount is advanced by the lending institution which is, in turn, repaid by the government.

Neither the contractor nor the lending institution has any interest in the further refinements and complications which are superimposed on this basic framework solely for governmental purposes. The government requires the contractor to create a fourth party—a corporation whose stock is initially issued to the contractor, then placed in escrow for the United States. This "mortgagor-builder corporation" signs a note as primary debtor on a federally guaranteed loan from the lending institution (although the government, and not the corporation, repays the loan) and makes payments to the contractor from the funds advanced by the lending institution (although payments can only be made at the direction of the government). The corporation acquires nothing for the funds it disburses and cannot profit from its services.

The question presented by these cases is whether the mortgagor-builder corporation, which is created and used solely for government purposes, is subject to a State sales tax. The basic constitutional and statutory framework is clear. The Washington sales tax, as authoritatively construed by the State court, is imposed upon the purchaser of constructed housing property.[1] A sales tax cannot constitutionally be imposed on the United States or its instrumentalities. *Kern-Limerick, Inc.* v. *Scurlock*, 347 U.S. 110. Whether the purchaser of the housing was the United States or its instrumentality is a question of federal law, reviewable by this Court on appeal. *Id.* at 121, 122. The Supreme Court of Washington held that the State tax is applicable to Capehart housing on the grounds that the mortgagor-builder corporation, not the United States, is the purchaser of this housing and that the corporation is not the agent or instrumentality of the United States.

2. The procedures for the financing and construction of Capehart housing are set forth in detail in the Jurisdictional Statements filed by the appellants in the present cases. See, in particular, Jurisdictional Statement in No. 850, pages 5–19. We therefore believe it is sufficient to summarize the ultimate legal consequences of the transactions which take place whenever such housing is constructed. These conse-

[1] Revised Code of Washington, §§ 82.08.020, 82.04.050. Since the tax can be collected from the seller-contractor when the buyer does not pay (§ 82.08.050), the State has assessed the tax against the contractors in the present case and they are the parties to this proceeding.

quences establish that Capehart housing is purchased by the United States through the medium of the mortgagor-builder corporation.

A. As noted above, the substance of a Capehart transaction is governmental acquisition of military housing by payment to a contractor of amounts initially advanced by a lending institution and then repaid to the lending institution by the United States. Like any purchaser the United States specifies the property it wishes constructed (Exs. 1 and 2). Indeed, it solicits and accepts bids before the mortgagor-builder corporation is even created (Ex. 3). The United States alone may accept or reject the construction work as it is done (Ex. 8, Articles XVIII and XV); and the United States can modify the terms of construction without the consent of the mortgagor-builder corporation (Ex. 8, General Provisions, par. 9). The government obtains from the contractor title and the right to possession of the housing; there is no time when the mortgagor-builder corporation owns or has the right to use the housing which the State has said it purchased (Ex. 6, pp. 1–2; Ex. 8, General Provisions, par. 14(c), and Article XIV). The funds used to pay the contractor are advanced by a lending institution on the strength of the government's credit; the corporation which signs the note as primary debtor has neither assets nor any prospect of obtaining assets and is thus without credit. The funds advanced are, pursuant to contract, repaid to the lender by the United States; it is never contemplated that they will be repaid by the corporation (Ex. 16, par. 2; Ex. 1, p. 1). The

United States has been held liable to the contractor for cancellation of the construction contract. See *G. L. Christian and Associates* v. *United States*, 312 F. 2d 418 (Ct. Cl.).

B. These facts establish that the United States, not the mortgagor-builder corporation, is the purchaser of Capehart housing. This conclusion is confirmed by additional evidence showing that the corporation is an almost empty shell, organized at the government's insistence and according to government-prescribed forms solely for government purposes (Ex. 4). It is, in short, a government instrumentality. The corporation has no real assets, no liabilities, and no authority to engage in business for its own profit. Its original paid-in capital of $1,000 is paid over to the government prior to construction in exchange for a 55-year leasehold under which the lessee has no rights of use or possession (Exs. 4 and 7). Its obligations and liabilities are all assumed and guaranteed either by the United States or the contractor (Ex. 8, Articles V, XXI, XXII). The corporation serves no private role. Neither the lending institution, which loans money on government credit and is repaid directly by the government, nor the contractor, which performs construction work for these amounts, benefits from the use of the corporate intermediary to sign a note and disburse the funds. The corporation itself receives no income and cannot possibly profit from the transaction (Ex. 1, p. 2, par. 1(e)).

The articles of incorporation restrict the functions of the corporation to performance of the Capehart

transaction (Ex. 4). The contract and lease, in turn, narrow the corporation's rights and responsibilities to those necessary for government purposes. It cannot accept or reject the work for which it disburses funds (Ex. 8, Articles IV and XVIII); it does not obtain title to or rights to use of the property (Ex. 6, p. 1; Ex. 8, General Provisions par. 14(c), and Article XIV); it cannot disburse funds except at the direction of the United States (Ex. 8, Article IV). Finally, these provisions are enforced by an escrow agreement under which, at all relevant times, the corporate stock and the signed resignations of the directors are irrevocably placed beyond the contractor's control and can be obtained by the United States by terminating performance of the construction for the convenience of the government (Ex. 11, p. 2).

3. Since, in our view, the Supreme Court of Washington erred in upholding the constitutionality of the State sales tax as applied to these purchases of Capehart housing by the United States, we think that these appeals present a substantial federal question. The highest courts of several other States have disagreed upon the issues.[6] Compare *Knapp-Stiles, Inc. v. Dept. of Revenue*, 370 Mich. 629, 122 N.W. 2d 642, with *Silberblatt, Inc. v. Tax Commission*, 5 N.Y. 2d 635, 159 N.E. 2d 195, certiorari denied, 361 U.S. 912;

[6] At the request of this Court (361 U.S. 892), the Solicitor General filed a brief in the *Silberblatt* case setting forth his views that the importance of the issues presented warranted issuance of the writ of certiorari.

see also *Green* v. *Eglin AFB Housing, Inc.*, 104 So. 2d 463, 467 (D.C. App. Fla.).

On the other hand, the question does not appear to have great continuing importance. New construction under the Capehart housing program is now coming to an end. Pursuant to Section 803(a) of the National Housing Act, as amended, 12 U.S.C. (Supp. IV) 1748b(a), no mortgages have been insured by the Federal Housing Commission under the Capehart Act since October 1, 1962. The major importance of the decision below is, therefore, that it subjects a useful form of private financing of government purchases to the undue threat of State taxation. If a method of financing similar to the Capehart device is used again in the future, as well it may be, the decision below and the disposition of the cases in this Court will stand as precedents defining the consequences of its use.

Since the questions presented by these appeals cannot be dismissed as insubstantial, it would seem that probable jurisdiction should be noted.

Respectfully submitted.,

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Solicitor General.

LOUIS F. OBERDORFER,
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JUNE 1964.

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[1] The United States has no direct financial interest in the present litigation. It is not obligated to reimburse the contractors for taxes they are required to pay.

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263 U.S. 341, 68 L.ed. 328, 44 Supreme Court 121, and followed in *United States v. Livingstone*, 179 F.Supp. 9; aff'd 364 U.S. 281, 4 L.ed.(2d) 1719, will be virtually destroyed. These cases cannot be reconciled with the majority decision in the present case.

We therefore submit that the Motion to Dismiss should be denied and these cases be set for full hearing on the merits.

Respectfully submitted,

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Dated April 17, 1964.

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REPLY OF APPELLEES TO MEMORANDUM FOR THE UNITED STATES

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ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

REPLY OF APPELLEES TO MEMORANDUM FOR THE UNITED STATES

I.

ANSWER OF ARGUMENT OF UNITED STATES CONCERNING PUBLIC IMPORTANCE OF THESE CASES

The Appellees find on page seven of the Memorandum of the United States a number of statements

with which we agree completely, and which demonstrate that these cases do not merit review by this Court.

First, the United States admits that it has no direct financial interest in these cases, because it is not obligated to reimburse the contractors for taxes they are required to pay.

Secondly, the United States goes even further and states that the question involved in these cases "* * * does not appear to have great continuing importance" because of the fact that the Capehart program is now "* * * coming to an end."

So far, then, the United States has given only very cogent reasons why these cases are *not* of great public importance and should *not* be reviewed. In its attempt to establish some sort of public importance for these cases, however, the argument of the United States is far from cogent.

The argument of the United States looks far into the future, to a hypothetical day on which Congress might decide to use a Capehart type of financing for some other types of governmental projects. The argument gives no intimation, however, of any projects that might be actually forthcoming, or what sort of projects they might be. But more importantly, it overlooks one important fact, viz., that if and when Congress decides to use a Capehart type of financing again, it can remove any "* * * threat of State taxation" by simply writing this "threat" out of existence.

Congress has the indisputable power to grant immunity from state taxation to private corporations in their dealings with the federal government. *Carson v. Roane-Anderson Co.*, 342 U. S. 232. It has merely to exercise this power in order to preserve a Capehart type of financing program from state taxation. It certainly does not take a decision by this Court to do the job.

It should be noted in passing that Congress has, in fact, used this power in the Capehart program, but only with regard to property taxes upon the leasehold interest of the mortgagor-corporations, and not with regard to sales taxes upon the mortgagor-corporations. (See section 408 of the Act of August 11, 1955, as amended by Section 511 of the Act of August 7, 1956, last proviso.)

Moreover, Congress has not only erected no barrier to state sales taxes, but the contract documents themselves indicate that no barrier exists.

Thus, Paragraph 14 of the Invitation for Bids (Ex. 1, p. IB-4) provides:

> "Nothing in this Invitation for Bids shall be deemed to relieve the eligible builder of any liability for the payment of sales or use taxes properly levied."

And Paragraph 41 (b) of the Housing Contract (Ex. 8, p. HC-27) provides as follows:

> "(b) Except as may be otherwise provided in this Housing Contract, the contract price includes all Federal, State and local taxes and duties in effect and applicable to this Housing Contract on the contract date, except taxes from

which the eligible builder or the transactions or property covered by this Housing Contract are then exempt. Duties and Federal transportation taxes are included in the contract price unless otherwise specifically excluded."

These provisions, drafted by the federal government, hardly manifest an intent on the part of the government that the mortgagor-corporations should be immune from state sales taxes.

The United States presents one other argument on this question of public importance, by stating erroneously on page six of the Memorandum that the highest courts of several other states have disagreed upon the issues presented here. The answer to this argument is two-fold.

Even if the assertion of the United States is correct, any such disagreement can be of little concern to this Court because, as the United States has stated, the Capehart program is ending and therefore any such disagreement is of no great public concern and is unlikely to present any problems in the future. But secondly, and more importantly, the assertion is simply not correct. As pointed out in Appellee's Motion to Dismiss, page twenty-seven, *Knapp-Stiles, Inc. v. Dept. of Revenue*, 370 Mich. 629, 122 N.W. (2d) 642, and *Green v. Eglin AFB Housing, Inc.*, 104 So. (2d) 463, each turned upon the interpretation of particular and peculiar state exemption statutes providing immunity much broader than demanded by the Federal Constitution.[1]

[1] Admittedly, the Michigan and Florida cases both contain *dicta* which appear to support the position of the United States and the Appellants; but the Appellees submit that a disagreement found solely in *dicta* is not the sort of disagreement that merits review by this Court.

On the other hand the only decision of another state Supreme Court expressly turning on the question of whether or not the mortgagor-corporation is a Federal instrumentality supports the decision involved in these appeals. *S. S. Silberblatt, Inc. v. Tax Commission of the State of New York*, 5 N. Y. (2d) 635, 159 N.E. (2d) 195, cert. den. 361 U. S. 912 (1959). (See discussions, Motion to Dismiss, pp. 26-29.)

In other words, every known decision of the highest courts of the several states concerning the application of state taxes to various phases of Capehart housing transactions are in harmony. The United States is thus denied this ground for asserting that a substantial question is presented which merits review of this Court.

II.

ANSWER TO ARGUMENT OF UNITED STATES CONCERNING CORRECTNESS OF DECISION

The Solicitor General has erred in his analysis of the statutes of the State of Washington as interpreted by the Washington Supreme Court. We respectfully submit that these errors deny the validity of the Solicitor's conclusion that these appeals "cannot be dismissed as 'insubstantial.'"

1. The United States asserts that the Supreme Court of Washington erred in upholding the constitutionality of the State Sales Tax " * * * as applied to these purchases of Capehart housing by

the United States * * *" (Memo for U. S., p. 6.)

However, the Solicitor acknowledges (a) that the mortgagor builder corporation pays the contractor for the costs of construction (p. 2) "* * * from the funds advanced by the lending institution." (p. 3) (b) The Solicitor also acknowledges that the "tax is on the purchaser" (p. 3).

However, the Solicitor refuses to recognize that under the State statutes in question *the purchaser is the person who pays the contractor.* (See Opinion Appendix A Jurisdictional Statement, Cause #849, pp. 9 to 10; Motion to Dismiss, pp. 20-21.)

Under the facts here, the contractor is paid by the mortgagor-corporation from proceeds of the loan to it by the private lending institution. Therefore, the mortgagor-corporation and *not* the United States is the "purchaser" under the state statute in question.

2. The United States says that the tax is imposed upon the United States because of the "ultimate legal consequences."

> "* * * We therefore believe it is sufficient to summarize the ultimate legal consequences of the transactions which take place whenever such housing is constructed. These consequences establish that Capehart housing is purchased by the United States through the medium of the mortgagor-builder corporation." Memo for U. S., pp. 3, 4.

Apparently the "ultimate legal consequences" to which the United States refers are:

(a) The control of the United States over the transactions.

(b) The ultimate repayment of the purchase price by the United States.

(c) The immediate acquisition of title by the United States.

But these three elements were present in *Alabama v. King & Boozer*, 314 U. S. 1, 86 L. ed. 3, 62 S. Ct. 43 (1941), and the United States relied upon these elements in its contention in that case that the United States was the purchaser, but nevertheless failed in its argument. *Alabama v. King & Boozer*, *supra*, is, therefore, dispositive of the question of whether the United States is "purchaser" under state law. See Motion to Dismiss, pp. 18-19.

3. Finally, the United States asserts that mortgagor-corporations are really Federal instrumentalities and that "neither the contractor nor the lending institution has any interest in the further refinements and complications [the mortgagor-corporation] which are superimposed on the basic framework inspired 'solely for governmental purposes' ". (Memo for U.S., p. 2) But it can scarcely be denied that certainly the contractor and the lending institution necessarily profit from the Capehart transactions, and to the extent that they profit they then have a monetary interest in the mortgagor-corporations.

Moreover these mortgagor-corporations were incorporated by the Appellants in Delaware, were capitalized by the Appellants, were qualified to do

business as private corporations in Washington, and had only private parties as officers, incorporators, and stockholders. All of these things were done by the Appellants in order that the Appellants might realize a profit. In short the mortgagor corporations served the Appellants and not simply the United States.

CONCLUSION

For the reasons stated in Appellee's Motion to Dismiss and this Reply to the Memorandum for the United States, these appeals should be dismissed for want of a substantial Federal question meriting review of this Court.

Respectfully submitted,

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